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TN REGULATORY AUTHORITY

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EXECUTIVE SECRETARY

October 18, 1999

Tennessee Regulatory Authority
Docketing
Telecommunications Division
460 James Robertson Parkway
Nashville, TN 37243

99-00823

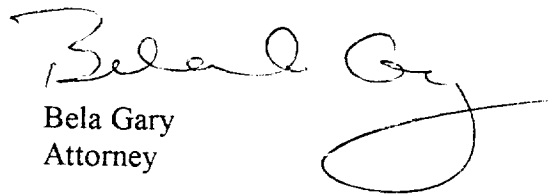
RE: Application of DIECA Communications, Inc. for a Certificate of Convenience and Authority to Provide Switched and Resold Local Exchange and Exchange Access Service Within Tennessee

Dear Sir or Madam:

DIECA Communications, Inc. (d/b/a Covad Communications Company) hereby submits the enclosed Application, seeking authority to operate as a reseller and provider of switched local exchange service and exchange access service within the State of Tennessee. An original and thirteen (13) copies are provided. Please date stamp one copy and return it in the postage-paid envelope provided to the undersigned.

Should there be any questions or additional information required, please do not hesitate to contact me at (408) 844-7564. Thank you.

Respectfully Submitted,


Bela Gary
Attorney

Enclosures

filed
25
CK # 1537

VERIFICATION

STATE OF CALIFORNIA

COUNTY OF SANTA CLARA

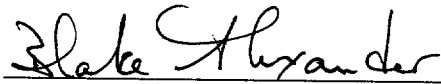
Dhruv Khanna, being first duly sworn, deposes and says: That he is the Vice President and Secretary for DIECA Communications, Inc., the applicant in the above proceeding; that he has read the foregoing application, and knows the contents thereof; and that he is authorized by DIECA Communications, Inc. to verify that the contents of the application are true.



Dhruv Khanna
DIECA Communications, Inc.
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

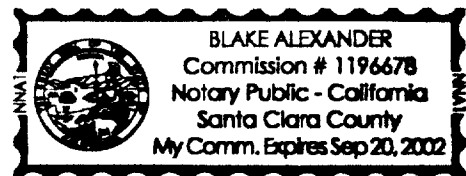
Subscribed and sworn to before me this

15th day of October, 1999



Notary Public
State of California

My commission expires: 9/20/02



BEFORE THE TENNESSEE REGULATORY AUTHORITY

Application of)	
)	
DIECA Communications, Inc.)	
)	Docket No. _____
For a Certificate to Provide Competing Local)	
Telecommunications Services)	

I. INTRODUCTION

Pursuant to applicable Tennessee Statutes and the Rules and Regulations of the Tennessee Regulatory Authority and Section 253 of the Federal Telecommunications Act of 1996 ("Act"), DIECA Communications, Inc. ("DIECA"), doing business as Covad Communications Company, by its undersigned counsel, respectfully requests that the Tennessee Regulatory Authority ("TRA") grant to DIECA authority to provide competing local telecommunications services, which include, among other things, dedicated private line services, and the provision of a full range of local and interexchange services within the State of Tennessee. DIECA is willing and able to comply with all applicable rules and regulations in Tennessee pertaining to the provision of competing local telecommunications services.

In support of this Application, DIECA provides the following information:

II. DESCRIPTION OF THE APPLICANT

1. Name, Address and Telephone Number of Applicant:

DIECA Communications, Inc.
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

2. Correspondence concerning this Application should be directed to:

Bela A. Gary
DIECA Communications, Inc.
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7564

or

Blake Alexander
DIECA Communications, Inc.
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7561

3. Questions concerning the ongoing operations of DIECA following certification should be directed to:

Bela A. Gary
DIECA Communications, Inc.
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7564

or

Blake Alexander
DIECA Communications, Inc.
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7561

4. The names, addresses, and telephone numbers of the officers of DIECA are as follows:

Charles J. McMinn
President
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

Dhruv Khanna
Vice-President and Secretary
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

Timothy P. Laehy
Treasurer
c/o Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

At this time, none of DIECA's officer's are located in Tennessee.

5. DIECA is a corporation incorporated under the laws of the State of Virginia. A copy of DIECA's Articles of Incorporation is attached hereto at Exhibit 1. In addition, a copy of DIECA's Authorization to Transact Business in Tennessee is attached at Exhibit 2.

6. DIECA is a wholly-owned subsidiary of Covad Communications Group, Inc. ("Covad"). Covad's address is:

Covad Communications Group, Inc.
2330 Central Expressway
Santa Clara, CA 95050

7. The company's contact for regulatory matters is:

W. Clay Deanhardt

Covad Communications Company
2330 Central Expressway
Santa Clara, CA 95050
(408) 844-7500

8. DIECA understands the importance of effective customer service for local service consumers. DIECA has made arrangements for its customers to call the company at its toll-free customer service number. In addition, customers may contact the company in writing at the headquarters address, as well as via email. The toll-free number will be printed on the customer's monthly billing statements.

9. Operations in Other States. DIECA and/or its affiliates are authorized to provide local exchange and interexchange telecommunications services in Arizona, California, Colorado, Connecticut, the District of Columbia, Delaware, Florida, Georgia, Illinois, Indiana, Kansas, Maryland, Maine, Michigan, Minnesota, Missouri, Montana, New Hampshire, New Jersey, New York, North Carolina, Oregon, Pennsylvania, Texas, Virginia, Washington, West Virginia, and Wisconsin. DIECA has not been denied authority to provide telecommunications service in any jurisdiction, nor is any negative action pending against the Company.

III. QUALIFICATIONS

1. Applicant's Financial Qualifications. DIECA is financially qualified to provide telecommunications services in Tennessee. In particular, DIECA has access to the financing and capital necessary to conduct its telecommunications operations as specified in the Application. In support of DIECA's Application, attached hereto at Exhibit 3 is a copy of DIECA's most recent financial statements. This exhibit is offered to demonstrate Applicant's financial ability to provide the proposed services.

2. Technical and Managerial Qualifications. DIECA's management team is well qualified to execute its business plan, to provide its proposed telecommunications services and to operate and maintain DIECA's facilities over which such services will be deployed.

DIECA is technically qualified to operate and manage its telecommunications operations in the State of Tennessee. Descriptions of the extensive telecommunications and managerial experience of DIECA's key personnel are attached hereto at Exhibit 4.

IV. PROPOSED SERVICE

1. DIECA's Proposed Service Offerings. DIECA seeks authority to provide all forms of telecommunications services.

DIECA seeks authority to offer local and exchange services to customers in areas throughout Tennessee. Exchange services will include, but will not be limited to the following: high speed "always on" connectivity using xDSL technology to connect (1) corporate customer employees to their corporate LAN/WANs from their residences and (2) customer internet service provider (ISP) end users from their residences and business premises to ISP facilities.

Initially, DIECA plans to offer services through a combination of purchased and leased assets. DIECA does not own, control, operate, or manage any conduits, ducts, poles, wires, cables, instruments, and appliances in connection with or to facilitate communication by telephone in the State of Tennessee.

DIECA intends to provide services to subscribers throughout the State of Tennessee, in areas currently served by BellSouth. To the extent that areas of Tennessee

are served by carriers that qualify as small or rural local exchange carriers under the Federal Act, DIECA does not intend to provide service in those areas at this time.

2. Underlying Carriers. DIECA has a signed interconnection agreement with BellSouth in Tennessee.

V. PUBLIC INTEREST CONSIDERATIONS

Grant of this Application will further the public interest by expanding the availability of competitive telecommunications services in the State of Tennessee. In particular, the public will benefit directly through the use of the competitive local services to be offered by DIECA. The public will also benefit indirectly because the competitive presence of DIECA in Tennessee will increase the incentives for other telecommunications providers to operate more efficiently, offer more innovative services, reduce their prices, and improve the quality of their services. In addition, offering of these services is in the public interest because the services will provide Tennessee customers with access to new technologies and service choices, and should permit customers to achieve increased efficiencies and cost savings. Therefore, DIECA's entry into the telecommunications market will materially enhance the telecommunications infrastructure in the State of Tennessee and will facilitate economic development.

VI. CONCLUSION

The telecommunications industry is growing and changing at an impressive pace. The entry of DIECA into the exchange and interexchange markets will enhance competition in the provision of telecommunications services within the State of

Tennessee, and will bring significant benefits to the telecommunications users in the State. DIECA's expertise in the telecommunications market will permit it to offer the most economic and efficient services, thereby providing customers with a better combination of price, quality, and customer service than other carriers. For the reasons stated herein, DIECA respectfully requests that the Commission find that approval of DIECA's Application is in the public interest and grant DIECA a Certificate of Public Convenience and Necessity to provide all forms of intrastate resold and facilities-based, switched and dedicated local and telephone exchange, exchange access, and interexchange telecommunications services throughout Tennessee.

VII. STATEMENT OF COMPLIANCE

DIECA agrees to abide by all applicable statutes and all applicable Orders, rules and regulations entered and adopted by the Tennessee Regulatory Authority.

Respectfully submitted this 15th day of October, 1999.



Bela A. Gary

EXHIBIT 1



STATE CORPORATION COMMISSION

Richmond,

September 26, 1997

This is to Certify that the certificate of incorporation of

DIECA Communications, Inc.

*was this day issued and admitted to record in this office
and that the said corporation is authorized to transact its business
subject to all Virginia laws applicable to the corporation and its
business. Effective date:*

September 26, 1997



State Corporation Commission

William J. Bridge
Clerk of the Commission

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

September 26, 1997

The State Corporation Commission has found the accompanying
articles submitted on behalf of

DIECA COMMUNICATIONS, INC.

to comply with the requirements of law, and confirms payment of
all related fees.

Therefore, it is ORDERED that this

CERTIFICATE OF INCORPORATION

be issued and admitted to record with the articles of
incorporation in the Office of the Clerk of the Commission,
effective September 26, 1997.

The corporation is granted the authority conferred on it by law in
accordance with the articles, subject to the conditions and
restrictions imposed by law.

STATE CORPORATION COMMISSION

By



Commissioner

CORPACPT
CIS20436
97-09-26-0146

COMMONWEALTH OF VIRGINIA
STATE CORPORATION COMMISSION

November 7, 1997

The State Corporation Commission has found the accompanying articles submitted on behalf of

DIECA COMMUNICATIONS, INC.

to comply with the requirements of law, and confirms payment of all related fees.

Therefore, it is ORDERED that this

CERTIFICATE OF AMENDMENT

be issued and admitted to record with the articles of amendment in the Office of the Clerk of the Commission, effective November 7, 1997 at 09:22 AM.

The corporation is granted the authority conferred on it by law in accordance with the articles, subject to the conditions and restrictions imposed by law.

STATE CORPORATION COMMISSION

By

A handwritten signature in black ink, appearing to read "J. V. Morrison", is written over the word "By".

Commissioner

AMENACPT
CIS20317
97-10-28-0040

**ARTICLES OF INCORPORATION
OF
DIECA COMMUNICATIONS, INC.**

The undersigned, pursuant to Chapter 9 of Title 13.1 of the Code of Virginia, state as follows:

I

The name of this corporation is DIECA Communications, Inc.

II

The number of shares the corporation is authorized to issue is 1,000 shares of Common Stock.

III

The corporation's initial registered office address which is the business address of the initial registered agent is:

5511 Staples Mill Road
Richmond, VA 23228


The initial registered office is physically located in the County of Henrico.

IV

The name of the corporation's initial registered agent is:


Edward R. Parker.

The initial registered agent is an individual who is a resident of Virginia and a member of the Virginia State Bar.



Charles J. McMinn
Incorporator

Dated: September 23 1997



Dhruv Khanna
Incorporator

ARTICLES OF AMENDMENT
OF
ARTICLES OF INCORPORATION
OF
DIECA COMMUNICATIONS, INC.

The undersigned, pursuant to Chapter 9 of Title 13.1 of the Code of Virginia, state as follows:

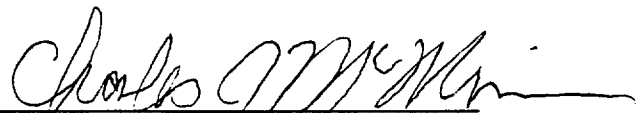
I

The name of this corporation is DIECA Communications, Inc. ("The Corporation").


II

Article V is hereby amended and adopted as follows: The Corporation is organized as a Public Service Company under the laws of the Commonwealth of Virginia. The purpose of the Corporation is to engage in the business of telecommunications services and all activities related thereto.

The above amendment is adopted as of October 24, 1997 and shareholder action is not required.



Charles J. McMinn
Incorporator



Dhruv Khanna
Incorporator

EXHIBIT 2

Secretary of State

Corporations Section

James K. Polk Building, Suite 1800

Nashville, Tennessee 37243-0306

ISSUANCE DATE: 06/02/1999
REQUEST NUMBER: 99153579

CHARTER/QUALIFICATION DATE: 06/01/1999
STATUS: ACTIVE
CORPORATE EXPIRATION DATE: PERPETUAL
CONTROL NUMBER: 0371717
JURISDICTION: VIRGINIA

TO:
CAPITAL FILING SERVICE, INC
7051 HIGHWAY 70 S
NO 333
NASHVILLE, TN 37221

REQUESTED BY:
CAPITAL FILING SERVICE, INC
7051 HIGHWAY 70 S
NO 333
NASHVILLE, TN 37221

I, RILEY C DARNELL, SECRETARY OF STATE OF THE STATE OF TENNESSEE DO HEREBY CERTIFY THAT

"DIECA COMMUNICATIONS INC."

WAS INCORPORATED OR QUALIFIED TO DO BUSINESS IN THE STATE OF TENNESSEE ON THE
ABOVE DATE, AND THAT THE ATTACHED DOCUMENT(S) WAS/WERE FILED IN OFFICE ON THE
DATE(S) AS BELOW INDICATED:

REFERENCE NUMBER	DATE FILED	FILING TYPE	FILING ACTION
3689-1608	06/01/1999	QUAL-PROFIT	NAM DUR STK PRN OFC AGT INC MAL FYC
3689-1610	06/01/1999	ASSUMED-ADD	

FOR: REQUEST FOR COPIES

ON DATE: 06/02/99

FROM:
CAPITAL FILING SERVICE, INC.
7051 HWY 70 S
#333
NASHVILLE, TN 37221-0000

FEE
RECEIVED: \$100.00 \$0.00
TOTAL PAYMENT RECEIVED: \$100.00

RECEIPT NUMBER: 00002504330
ACCOUNT NUMBER: 00101230



Riley C Darnell

RILEY C. DARNELL
SECRETARY OF STATE

RECEIVED
SECRET
99 JUN -1 AM 11:45
FILED

APPLICATION FOR REGISTRATION OF ASSUMED CORPORATE NAME

Pursuant to the provisions of Section 48-14-101(d) of the Tennessee Business Corporation Act or Section 48-54-101(d) of the Tennessee Nonprofit Corporation Act, the undersigned corporation hereby submits this application:

1. The true name of the corporation is DIECA Communications, Inc.
2. The state or country of incorporation is Virginia
3. The corporation intends to transact business in Tennessee under an assumed corporate name.
4. The assumed corporate name the corporation proposes to use is
Covad Communications Company

[NOTE: The assumed corporate name must meet the requirements of Section 48-14-101 of the Tennessee Business Corporation Act or Section 48-54-101 of the Tennessee Nonprofit Corporation Act.]

May 12, 1999
Signature Date

DIECA Communications, Inc.
Name of Corporation

VP + Secretary
Signer's Capacity

[Signature]
Signature

Dhruv Khanna
Name (typed or printed)



Pursuant to the provisions of Section 48-25-103 of the Tennessee Business Corporation Act, the undersigned corporation hereby applies for a certificate of authority to transact business in the State of Tennessee, and for that purpose sets forth:

1. The name of the corporation is DIECA Communications, Inc.

RECEIVED
SECRETARY OF STATE

FILED

If different, the name under which the certificate of authority is to be obtained is 99 JUN -1 AM 11:45

[NOTE: The Secretary of State of the State of Tennessee may not issue a certificate of authority to a foreign corporation for profit if its name does not comply with the requirements of Section 48-14-101 of the Tennessee Business Corporation Act. If obtaining a certificate of authority under an assumed corporate name, an application must be filed pursuant to Section 48-14-101(d).]

2. The state or country under whose law it is incorporated is Virginia

3. The date of its incorporation is 9/26/97 (must be month, day, and year), and the period of duration, if other than perpetual, is perpetual

4. The complete street address (including zip code) of its principal office is

2330 Central Expressway, Santa Clara CA 95050
Street City State/Country Zip Code

5. The complete street address (including the county and the zip code) of its registered office in this state is

1912 Hayes St. Nashville, TN 37203
Street City/State County Zip Code

The name of its registered agent at that office is

National Registered Agents, Inc.

6. The names and complete business addresses (including zip code) of its current officers are: (Attach separate sheet if necessary.)

Robert E. Knowling, Jr. - President 2330 Central Expressway, Santa Clara, CA 95050
Dhruv Khanna - VP and Secretary 2330 Central Expressway, Santa Clara, CA 95050
Timothy P. Laehy - Treasurer 2330 Central Expressway, Santa Clara, CA 95050

7. The names and complete business addresses (including zip code) of its current board of directors are: (Attach separate sheet if necessary.)

Robert E. Knowling, Jr. 2330 Central Expressway, Santa Clara, CA 95050
Dhruv Khanna 2330 Central Expressway, Santa Clara, CA 95050
Timothy P. Laehy 2330 Central Expressway, Santa Clara, CA 95050

8. The corporation is a corporation for profit.

9. If the document is not to be effective upon filing by the Secretary of State, the delayed effective date/time is

 , 19 (date), (time).

[NOTE: A delayed effective date shall not be later than the 90th day after the date this document is filed by the Secretary of State.]

[NOTE: This application must be accompanied by a certificate of existence (or a document of similar import) duly authenticated by the Secretary of State or other official having custody of corporate records in the state or country under whose law it is incorporated. The certificate shall not bear a date of more than one (1) month prior to the date the application is filed in this state.]



EXHIBIT 3

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934.

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 1999.

Commission file number: 000-25271

COVAD COMMUNICATIONS GROUP, INC.

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction
of incorporation or organization)

77-0461529

(I.R.S. Employer
Identification Number)

**2330 Central Expressway
Santa Clara, California**

(Address of principal executive offices)

95050

(Zip Code)

(408) 844-7500

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ☒ No ☐

As of August 2, 1999, 71,741,225 shares of the Registrants Common Stock, \$0.001 par value, were issued and outstanding.

**COVAD COMMUNICATIONS GROUP, INC.
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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

COVAD COMMUNICATIONS GROUP, INC.

CONSOLIDATED BALANCE SHEETS (Amounts in 000's, except share and per share amounts)

	June 30, 1999 (unaudited)	December 31, 1998 (note 1)
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 257,471	\$ 64,450
Accounts receivable, net.....	6,637	1,933
Short term investments.....	45,638	—
Unbilled revenue.....	2,334	663
Inventories.....	9,470	946
Prepaid expenses.....	4,310	1,183
Other current assets.....	2,218	514
Total current assets.....	328,078	69,689
Property and equipment:		
Networks and communication equipment.....	143,184	55,189
Computer equipment.....	9,639	4,426
Furniture and fixtures.....	1,469	1,119
Leasehold improvements.....	2,077	1,887
	156,369	62,621
Less accumulated depreciation and amortization.....	(12,807)	(3,476)
Net property and equipment.....	143,562	59,145
Other assets:		
Restricted investments.....	75,631	225
Deposits.....	628	337
Deferred debt issuance costs (net).....	12,989	8,112
Deferred charge (net).....	24,713	—
Other long term assets.....	8,215	1,911
Total other assets.....	122,176	10,585
Total assets.....	<u>\$ 593,816</u>	<u>\$ 139,419</u>
LIABILITIES AND STOCKHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)		
Current liabilities:		
Accounts payable.....	\$ 31,900	\$ 14,975
Unearned revenue.....	1,702	551
Accrued network costs.....	4,797	1,866
Other accrued liabilities.....	19,557	3,854
Current portion of capital lease obligations.....	284	263
Total current liabilities.....	58,240	21,509
Long-term debt (net of discount).....	363,406	142,300
Long-term capital lease obligations.....	166	316
Total liabilities.....	421,812	164,125
Stockholders' equity (net capital deficiency):		
Convertible preferred stock (\$0.001 par value):		
Authorized shares—0 at June 30, 1999 and 30,000,000 at December 31, 1998, respectively		
Issued and outstanding shares—0 and 18,246,162 at June 30, 1999 and December 31, 1998, respectively.....	—	18
Preferred stock (\$0.001 par value):		
Authorized shares—5,000,000 and 0 at June 30, 1999 and December 31, 1998, respectively		
Issued and outstanding shares—0 at June 30, 1999 and December 31, 1998, respectively.....	—	—
Common stock (\$0.001 par value):		
Authorized shares—190,000,000 and 65,000,000 at June 30, 1999 and December 31, 1998, respectively		
Issued and outstanding shares—71,136,940 and 17,660,995 at June 30, 1999 and December 31, 1998, respectively.....	72	18
Common stock - Class B (\$0.001 par value):		
Authorized shares— 10,000,000 and 0 at June 30, 1999 and December 31, 1998, respectively		
Issued and outstanding shares— 6,379,177 and 0 at June 30, 1999 and December 31, 1998, respectively.....	6	—
Additional paid-in capital.....	271,325	30,679
Deferred compensation.....	(3,548)	(4,688)
Accumulated other comprehensive income.....	25,638	—
Accumulated deficit.....	(121,489)	(50,733)
Total stockholders' equity (net capital deficiency).....	172,004	(24,706)
Total liabilities and stockholders' equity (net capital deficiency).....	<u>\$ 593,816</u>	<u>\$ 139,419</u>

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS (Amounts in 000's, except share and per share amounts) (unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
Revenues.....	\$ 10,833	\$ 809	\$ 16,429	\$ 995
Operating expenses:				
Network and product costs.....	10,565	758	15,525	961
Sales, marketing, general and administrative.....	24,976	4,606	43,089	6,550
Amortization of deferred compensation.....	1,234	631	2,887	858
Depreciation and amortization.....	8,671	446	13,318	610
Total operating expenses.....	45,446	6,441	74,819	8,979
Income (loss) from operations.....	(34,613)	(5,632)	(58,390)	(7,984)
Interest income (expense):				
Interest income.....	4,585	1,712	8,094	2,147
Interest expense.....	(11,824)	(5,003)	(20,460)	(5,867)
Net interest income (expense).....	(7,239)	(3,291)	(12,366)	(3,720)
Net income (loss).....	\$ (41,852)	\$ (8,923)	\$ (70,756)	\$ (11,704)
Basic and diluted net income (loss) per common share.....	\$ (0.61)	\$ (1.11)	\$ (1.18)	\$ (1.54)
Weighted average shares used in computing basic and diluted net loss per share.....	68,157,273	8,050,771	60,930,856	7,584,501

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in 000's)
(unaudited)

	Six Months Ended June 30,	
	<u>1999</u>	<u>1998</u>
Net cash provided by (used in) operating activities	\$ (27,721)	\$ (877)
Investing activities:		
Purchase of restricted investments	(74,103)	—
Purchase of investments.....	(20,000)	—
Deposits	(291)	(13)
Other long-term assets	(6,304)	—
Purchase of property and equipment.....	(93,748)	(12,367)
Net cash used in investing activities	(194,446)	(12,380)
Financing activities:		
Net proceeds from issuance of long-term debt and warrants	—	129,622
Net proceeds from issuance of long-term debt	205,076	—
Principal payments under capital lease obligations	(129)	(122)
Proceeds from common stock issuance, net of offering costs	150,318	64
Proceeds from preferred stock issuance	60,000	1,200
Preferred dividends	(77)	—
Net cash provided by financing activities	415,188	130,764
Net increase in cash and cash equivalents	193,021	117,507
Cash and cash equivalents at beginning of period	64,450	4,378
Cash and cash equivalents at end of period	<u>\$ 257,471</u>	<u>\$ 121,885</u>
Supplemental disclosures of cash flow information:		
Cash paid during the period for interest.....	\$ 43	\$ 48
Supplemental schedule of non-cash investing and financing activities:		
Equipment purchased through capital leases	\$ —	\$ 34
Warrants issued for equity commitment	\$ —	\$ 2,928

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

1. Summary of Significant Accounting Policies

A. Basis of Presentation

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates. The consolidated financial statements of the Company include the accounts of all of its wholly-owned subsidiaries. There were no intercompany accounts and transactions which required elimination.

The financial statements at June 30, 1999 and for the three and six month periods ended June 30, 1999 and 1998 are unaudited, but include all adjustments (consisting only of normal recurring adjustments) that the Company considers necessary for a fair presentation of financial position and operating results. Operating results for the three and six month periods ended June 30, 1999 and 1998 are not necessarily indicative of results that may be expected for any future periods.

The balance sheet at December 31, 1998 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements.

The information included in this report should be read in conjunction with the Company's audited consolidated financial statements and notes thereto included in the Company's 1998 Annual Report on Form 10-K.

B. Earnings (Loss) Per Share

Basic earnings per share is computed by dividing income or loss applicable to common shareholders by the weighted average number of shares of the Company's common stock ("Common Stock"), after giving consideration to shares subject to repurchase, outstanding during the period.

Diluted earnings per share is determined in the same manner as basic earnings per share except that the number of shares is increased assuming exercise of dilutive stock options and warrants using the treasury stock method and conversion of the Company's convertible preferred stock ("Preferred Stock"). In addition, income or loss is adjusted for dividends and other transactions relating to preferred shares for which conversion is assumed. The diluted earnings per share amount has not been reported because the Company has a net loss and the impact of the assumed exercise of the stock options and warrants and the assumed preferred stock conversion is not dilutive.

Under the Company's Certificate of Incorporation, all outstanding Preferred Stock converted into Common Stock on a one-for-one basis upon the completion of the Company's initial public offering of Common Stock (see note 5).

The consolidated financial statements applicable to the prior periods have been restated to reflect a two-for-one stock split effective May 1998, a three-for-two stock split effective August 1998, and a three-for-two stock split effective May 1999.

The following table presents the calculation of basic and diluted net income (loss) per share (in thousands, except share and per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
Net loss.....	\$ (41,852)	\$ (8,923)	\$ (70,756)	\$ (11,704)
Preferred dividends	—	—	(1,146)	—
Net loss available to common stockholders.....	\$ (41,852)	\$ (8,923)	\$ (71,902)	\$ (11,704)
Basic and diluted:				
Weighted average shares of common stock outstanding	73,808,148	17,202,646	67,032,023	17,196,137
Less: Weighted average shares subject to repurchase	<u>5,650,875</u>	<u>9,151,875</u>	<u>6,101,167</u>	<u>9,611,636</u>
Weighted average shares used in computing basic and diluted net income (loss) per share	<u>68,157,273</u>	<u>8,050,771</u>	<u>60,930,856</u>	<u>7,584,501</u>
Basic and diluted net income (loss) per share	<u>\$ (0.61)</u>	<u>\$ (1.11)</u>	<u>\$ (1.18)</u>	<u>\$ (1.54)</u>

2. Comprehensive Income

Comprehensive income for the three and six months ended June 30, 1999 and 1998 was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	1999	1998	1999	1998
Net loss.....	\$ (41,852)	\$ (8,923)	\$ (70,756)	\$ (11,704)
Unrealized holding gains (losses).....	<u>25,638</u>	<u>—</u>	<u>25,638</u>	<u>—</u>
Comprehensive income.....	<u>\$ (16,214)</u>	<u>\$ (8,923)</u>	<u>\$ (45,118)</u>	<u>\$ (11,704)</u>

3. Short-Term Investments

Short-term investments at June 30, 1999 consisted of the following (in thousands):

Equity position in WebMD, Inc.....	\$ 15,000
Equity position in Efficient Networks, Inc.	5,000
Unrealized holding gains (losses).....	<u>25,638</u>
	<u>\$ 45,638</u>

The costs of these investments are reflected on the balance sheet along with their related unrealized holding gain or loss in order to approximate fair market value.

4. Debt

On February 18, 1999, the Company completed a private placement (the "1999 Notes") of \$215 million aggregate principal amount of the Company's 12½% senior notes due 2009. The 1999 Notes are unsecured senior

obligations of the Company maturing on February 15, 2009 and are redeemable at the option of the Company any time after February 14, 2004 at stated redemption prices plus accrued and unpaid interest thereon.

Net proceeds from the 1999 Notes were approximately \$205.1 million, after discounts, commissions and other transaction costs of approximately \$9.9 million. The discount and debt issuance costs are being amortized over the life of the 1999 Notes. For the six months ended June 30, 1999, the amortization of debt discount and debt issuance costs was \$166,000 and \$190,000, respectively.

Concurrently with the closing of the offering, approximately \$74.1 million of the net proceeds was used to purchase government securities representing sufficient funds to pay the first six scheduled interest payments on the 1999 Notes. This reserve, along with earned interest, is recorded as restricted investments on the accompanying balance sheet.

On June 1, 1999, the Company completed an offer to exchange all outstanding 12½% Senior Notes due February 15, 2009 for 12½% Senior Notes due February 15, 2009, which have been registered under the Securities Act of 1933.

5. Stockholders' Equity

Covad Communications Group, Inc.

Strategic Investment:

In January 1999, the Company entered into strategic relationships with AT&T Corp. ("AT&T"), NEXTLINK Communications, Inc. ("NEXTLINK") and Qwest Communications Corporation ("Qwest"). As part of these strategic relationships, the Company received equity investments totaling approximately \$60 million. The Company recorded intangible assets of \$28.7 million associated with these transactions which will be amortized over periods of three to six years.

Initial Public Offering:

On January 27, 1999, the Company completed the IPO of 13,455,000 split-adjusted shares of the Company's common stock at a split-adjusted price of \$12.00 per share. Net proceeds to the Company from the IPO were \$150.2 million after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company. As a result of the IPO, 27,369,243 split-adjusted shares of Common Stock and 6,379,177 shares of Class B Common Stock (which are convertible into 9,568,765 split-adjusted shares of Common Stock) were issued upon the conversion of Preferred Stock, 89,058 split-adjusted shares of Common Stock were issued for cumulative but unpaid dividends on series A and series B Preferred Stock and 2,699,626 split-adjusted shares of Common Stock were issued upon the exercise of common warrants.

Secondary Offering:

On June 23, 1999, the Company completed a public offering of 8,625,000 shares of Common Stock sold by certain stockholders of the Company. The Company did not sell any shares in this offering. Accordingly, there were no net proceeds to the Company from this offering. The Company is expected to incur estimated offering expenses of \$680,000.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

The following discussion of the financial condition and results of operations of the Company should be read in conjunction with the consolidated financial statements and the related notes thereto included elsewhere in this Form 10-Q and the consolidated audited financial statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations for the year ended December 31, 1998 included in the Company's Annual Report on Form 10-K. This discussion contains forward-looking statements the accuracy of which involves risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements for many reasons including, but not limited to, those discussed herein and in our Registration Statement on Form S-1 (SEC File No. 333-78827). We disclaim any obligation to update information contained in any forward-looking statement or in the reasons why such forward-looking statements may differ materially from actual results, which reasons speak as of their dates. See "Forward Looking Statements"

Overview

We are a leading high-speed Internet and network access provider offering digital subscriber line ("DSL") services to Internet service provider and enterprise customers. Since March 1998, we have raised \$569.0 million of gross proceeds from debt and equity financings to fund the deployment and expansion of our networks. Currently, we offer our services in 21 major metropolitan areas and plan to build our networks and offer our services in one additional metropolitan area representing a total of 51 metropolitan statistical areas nationwide.

In connection with our expansion within existing regions and into new regions, we expect to significantly increase our capital expenditures, as well as our sales and marketing expenditures, to deploy our networks and support additional end-users in those regions. Accordingly, we expect to incur substantial and increasing net losses for at least the next several years.

We derive revenue from:

- monthly recurring service charges for connections from the end-user to our facilities and for backhaul services from our facilities to the Internet service provider or enterprise customer;
- service order set-up and other non-recurring charges; and
- the sale of customer premise equipment that we provide to our customers due to the general unavailability of customer premise equipment through retail channels.

We expect prices for the major components of both recurring and non-recurring revenues to decrease each year in part due to the effects of competitive pricing and future volume discounts. We believe our revenues from the sale of customer premise equipment will decline over time, as prices for such equipment decrease and customer premise equipment becomes more generally available.

The following factors comprise our network and service costs:

- Monthly non-recurring and recurring circuit fees. We pay traditional telephone companies and other competitive telecommunications companies non-recurring and recurring fees for services including installation, activation, monthly line costs, maintenance and repair of circuits between and among our digital subscriber line access multiplexers and our regional data centers, customer backhaul, and end-user lines. As our end-user base grows, we expect that the largest element of network and product cost will be the traditional telephone companies' charge for our leased copper lines; and
- Other costs. Other costs that we incur include those for materials in installation and the servicing of customers and end-users, and the cost of customer premise equipment.

The development and expansion of our business will require significant expenditures. The principal capital expenditures incurred during the buildup phase of any region involve the procurement, design and construction of our central office cages, end-user DSL line cards, and expenditures for other elements of our network design, which includes a regional data center in each region. Following the buildout of our central office space, the major portion of our capital expenditures is success based, used to purchase DSL line cards to support incremental end-users. We expect that the average cost of such line cards will decline over the next several years. Network expenditures will continue to increase with the number of end-users. However, once an operating region is fully built out, a substantial majority of the regional capital expenditures will be tied to incremental customer and end-user growth. In addition to developing our networks, we will use our capital for marketing our services, acquiring Internet service provider and enterprise customers, and funding our customer care and field service operations.

Results of Operations

Revenues

We recorded revenues of \$10.8 million for the three months ended June 30, 1999 compared to \$809,000 for the three months ended June 30, 1998. Revenue was \$16.4 million for the six months ended June 30, 1999 compared to \$995,000 for the six months ended June 30, 1998. This increase is attributable to growth in the number of customers and end-users resulting from our increased sales and marketing efforts and the expansion of our national network. We expect revenues to increase in future periods as we expand our network within our existing regions, deploy networks in new regions and increase our sales and marketing efforts in all of our regions.

Network and Product Costs

We recorded network and product costs of \$10.6 million for the three months ended June 30, 1999 and \$758,000 for the three months ended June 30, 1998. Network and product costs were \$15.5 million for the six months ended June 30, 1999 and \$961,000 for the six months ended June 30, 1998. This increase is attributable to the expansion of our networks and increased orders resulting from our sales and marketing efforts. We expect network and product costs to increase significantly in future periods due to increased sales activity and expected revenue growth.

Sales, Marketing, General and Administrative Expenses

Sales, marketing, general and administrative expenses consist primarily of salaries, expenses for the development of our business, the development of corporate identification, promotional and advertising materials, expenses for the establishment of our management team, and sales commissions. Sales, marketing, general and administrative expenses were \$25.0 million for the three months ended June 30, 1999 and \$4.6 million for the three months ended June 30, 1998. Sales, marketing, general and administrative expenses were \$43.1 million for the six months ended June 30, 1999 and \$6.6 million for the six months ended June 30, 1998. This increase is attributable to growth in headcount in all areas of our company, continued expansion of our sales and marketing efforts, deployment of our networks and building of our operating infrastructure. Sales, marketing, general and administrative expenses are expected to increase significantly as we continue to expand our business.

Deferred Compensation

Through June 30, 1999, we recorded a total of approximately \$10.7 million of deferred compensation, with an unamortized balance of approximately \$3.5 million on our June 30, 1999 balance sheet. This deferred compensation is a result of us granting stock options to our employees, certain of our directors, and certain contractors

with exercise prices per share below the fair values per share for accounting purposes of our common stock at the dates of grant. We are amortizing the deferred compensation over the vesting period of the applicable option. Amortization of deferred compensation was \$1.2 million for the three months ended June 30, 1999 and \$631,000 for the three months ended June 30, 1998. Amortization of deferred compensation was \$2.9 million for the six months ended June 30, 1999 and \$858,000 for the six months ended June 30, 1998.

Depreciation and Amortization

Depreciation and amortization includes:

- depreciation of network costs and related equipment;
- depreciation of information systems, furniture and fixtures;
- amortization of improvements to central offices, regional data centers and network operations center facilities and corporate facilities;
- amortization of capitalized software costs; and
- amortization of intangible assets.

In January 1999, we recorded intangible assets of \$28.7 million from the issuance of preferred stock to AT&T Ventures, NEXTLINK and Qwest. Amortization of these assets was \$2.1 million and \$4.0 million during the three and six months ended June 30, 1999, respectively. Annual amortization of these assets will be approximately \$8.4 million in each of the years in the three year period ending December 31, 2001, decreasing to approximately \$1.2 million per year for each subsequent year through the year ending December 31, 2004.

Depreciation and amortization was approximately \$8.7 million for the three months ended June 30, 1999 and \$446,000 for the three months ended June 30, 1998. Depreciation and amortization was approximately \$13.3 million for the six months ended June 30, 1999 and \$610,000 for the six months ended June 30, 1998. This increase was due to the increase in equipment and facilities placed in service throughout the period as well as amortization of intangible assets. We expect depreciation and amortization to increase significantly as we increase our capital expenditures to expand our networks.

Net Interest Income and Expense

Net interest income and expense consists primarily of interest income on our cash balance and interest expense associated with our debt. Net interest expense for the three and six months ended June 30, 1999, was \$7.2 million and \$12.3 million, respectively. Net interest expense during these periods consisted primarily of interest expense on the 1998 notes and the 1999 notes and capital lease obligations partially offset by interest income earned primarily from the investment of the proceeds raised from the issuance of the 1998 notes and the 1999 notes as well as our initial public offering and our issuance of preferred stock to AT&T Ventures, NEXTLINK and Qwest. Net interest expense for the three and six months ended June 30, 1998, was \$3.3 million and \$3.7 million, respectively. Net interest expense during these periods consisted primarily of interest expense on the 1998 notes and capital lease obligations, partially offset by interest income earned primarily from the investment of the proceeds raised from the issuance of the 1998 notes. We expect interest expense to increase significantly over time, primarily because the 1998 notes accrete to \$260 million by March 15, 2003.

Liquidity and Capital Resources

Our operations have required substantial capital investment for the procurement, design and construction of our central office cages, the purchase of telecommunications equipment and the design and development of our networks. Capital expenditures were approximately \$93.7 million for the six months ended June 30, 1999. We expect

that our capital expenditures will be substantially higher in future periods in connection with the purchase

of infrastructure equipment necessary for the development and expansion of our networks and the development of new regions.

From our inception through June 30, 1999, we financed our operations primarily through private placements of \$10.6 million of equity securities, \$129.3 million in net proceeds raised from the issuance of the 1998 notes, \$150.2 million in net proceeds raised from our initial public offering, \$60.0 million in net proceeds raised from strategic investors and \$205.1 million in net proceeds raised from the issuance of the 1999 notes. As of June 30, 1999, we had an accumulated deficit of \$121.5 million, and cash and cash equivalents of \$257.5 million.

Net cash used in our operating activities was \$27.7 million for the six months ended June 30, 1999. The net cash used for operating activities during this period was primarily due to net losses and increases in current assets, offset by non-cash expenses and increases in accounts payable and accrued liabilities. Net cash used in our investing activities was \$194.4 million for the six months ended June 30, 1999. The net cash used for investing activities during this period was primarily due to purchases of property and equipment, the purchase of \$74.1 million of restricted investments which were pledged as collateral for the payment of the first six scheduled interest payments on the 1999 notes, and an aggregate \$20 million equity investment made in WebMD, Inc. and Efficient Networks, Inc.

Net cash provided by financing activities for the six months ended June 30, 1999 was \$415.2 million which primarily related to the following:

- Equity investments of \$25 million from AT&T Ventures, \$20 million from NEXTLINK and \$15 million from Qwest, representing an aggregate equity investment of \$60 million.
- Net proceeds of \$150.2 million from our initial public offering of 13,455,000 split-adjusted shares of our common stock at a split-adjusted initial public offering price of \$12.00 per share.
- Net proceeds of \$205.1 million from the issuance of the 1999 notes with an aggregate principal amount of \$215.0 million.

Net cash provided by financing activities was partially offset by an estimated \$680,000 in offering costs applicable to our secondary offering of 7,500,000 shares in June 1999 for which we received no proceeds.

We expect to experience substantial negative cash flow from operating activities and negative cash flow before financing activities for at least the next several years due to continued development, commercial deployment and expansion of our networks. We may also make investments in businesses that are complementary to ours to support the growth of our business. Our future cash requirements for developing, deploying and enhancing our networks and operating our business, as well as our revenues, will depend on a number of factors including:

- the number of regions entered, the timing of entry and services offered;
- network development schedules and associated costs;
- the rate at which customers and end-users purchase our services and the pricing of such services;
- the level of marketing required to acquire and retain customers and to attain a competitive position in the marketplace;
- the rate at which we invest in engineering and development and intellectual property with respect to existing and future technology; and
- unanticipated opportunities.

Accordingly, we will be required to raise additional capital, the timing and amount of which we cannot predict. As a result, we expect to raise additional capital through debt or equity financings, depending on market conditions, to finance the continued development, commercial deployment and expansion of our networks and for funding operating losses or to take advantage of unanticipated opportunities. If we are unable to obtain required additional capital or are required to obtain it on terms less satisfactory than we desire, we may be required to delay the expansion of our business or take or forego actions, any or all of which could harm our business.

In addition, we may wish to selectively pursue possible acquisitions of or investments in businesses, technologies or products complementary to ours in the future in order to expand our geographic presence and achieve operating efficiencies. We may not have sufficient liquidity, or we may be unable to obtain additional debt or equity financing on favorable terms or at all, in order to finance such an acquisition or investment.

Year 2000 Issues

Many currently installed computer systems and software products are coded to accept only two-digit entries in the date code field and cannot distinguish 21st century dates from 20th century dates. These date code fields will need to distinguish 21st century dates from 20th century dates and, as a result, many companies' software and computer systems may need to be upgraded or replaced in order to comply with such "Year 2000" requirements. We have reviewed our internally developed information technology systems and programs and believe that our systems are Year 2000 compliant and that there are no significant Year 2000 issues within our systems or services. We have not reviewed our non-information technology systems for Year 2000 issues relating to embedded microprocessors. To the extent that such issues exist, these systems may need to be replaced or upgraded to become Year 2000 compliant. We believe that our non-information technology systems will not present any significant Year 2000 issues, although there can be no assurance in this regard. In addition, we utilize third-party equipment and software and interact with traditional telephone companies that have equipment and software that may not be Year 2000 compliant. Failure of such third-party or traditional telephone company equipment or software to operate properly with regard to the year 2000 and thereafter could require us to incur unanticipated expenses to remedy any problems, which could have a material adverse effect on our business, prospects, operating results and financial condition.

Furthermore, the purchasing patterns of our Internet service provider and enterprise customers may be affected by Year 2000 issues as companies expend significant resources to correct their current systems for Year 2000 compliance. These expenditures may result in reduced funds available for our services, which could have a material adverse effect on our business, prospects, operating results and financial condition.

We have not made any assessment of the Year 2000 risks associated with our third-party or traditional telephone company equipment or software or with our Internet service provider and enterprise customers. We have not determined the risks associated with the reasonably likely worst-case scenario and have not made any contingency plans to address such risks. However, we intend to devise a Year 2000 contingency plan prior to December 31, 1999.

Forward Looking Statements

The statements contained in this report that are not historical facts are "forward-looking statements" (as such term is defined in Section 27A of the Securities Act of 1933 and section 21E of the Securities Exchange Act of 1934), which can be identified by the use of forward-looking terminology such as "estimates," "projects," "anticipates," "expects," "intends," "believes," or the negative thereof or other variations thereon or comparable terminology, or by discussions of strategy that involve risks and uncertainties. Examples of such forward-looking statements include:

- our plans to expand our existing networks or to commence service in new regions;
- expectations as to pricing for our services in the future;
- statements regarding development of our business;
- the possibility that we may obtain significantly increased sales volumes;
- the estimates of future operating results;
- our anticipated capital expenditures; and
- other statements contained in this Form 10-Q regarding matters that are not historical facts.

These statements are only estimates or predictions and cannot be relied upon. We can give you no assurance that future results will be achieved. Actual events or results may differ materially as a result of risks facing us or actual results differing from the assumptions underlying such statements. Such risks and assumptions that could cause actual results to vary materially from the future results indicated, expressed or implied in such forward-looking statements include our ability to:

- successfully market our services to current and new customers;
- generate customer demand for our services in the particular regions where we plan to market services;
- achieve favorable pricing for our services;
- respond to increasing competition;
- manage growth of our operations; and
- access regions and negotiate suitable interconnection agreements with the traditional phone companies, all in a timely manner, at reasonable costs and on satisfactory terms and conditions consistent with regulatory, legislative and judicial developments.

All written and oral forward-looking statements made in connection with this report on Form 10-Q which are attributable to us or persons acting on our behalf are expressly qualified in their entirety by the "Risk Factors" and other cautionary statements included in our Registration Statement on Form S-1 (Commission File No. 333-78827). We disclaim any obligation to update information contained in any forward-looking statement or in the reasons why such forward-looking statements may differ materially from actual results, which reasons speak as of their dates.

Quantitative and Qualitative Disclosures about Market Risk

Our exposure to financial market risk, including changes in interest rates and marketable equity security prices, relates primarily to our investment portfolio and outstanding debt obligations. We typically do not attempt to reduce or eliminate our market exposure on our investment securities because a substantial majority of our investments are in fixed-rate, short-term securities. We do not have any derivative instruments. The fair value of our investments portfolio or related income would not be significantly impacted by either a 100 basis point increase or decrease in interest rates due mainly to the fixed-rate, short-term nature of the substantial majority of our investment portfolio. In addition, substantially all of our outstanding indebtedness at June 30, 1999 including our 1998 notes and our 1999 notes, is fixed-rate debt.

COVAD COMMUNICATIONS GROUP, INC.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

We are engaged in a variety of negotiations, arbitrations and regulatory and court proceedings with multiple traditional telephone companies. These negotiations, arbitrations and proceedings concern the traditional telephone companies' denial of physical central office space to us in certain central offices, the cost and delivery of central office spaces, the delivery of transmission facilities and telephone lines, billing issues and other operational issues. For example, we are currently involved in commercial arbitration proceedings with Pacific Bell over these issues. We have also filed a lawsuit against Pacific Bell and its affiliates, including Southwestern Bell Telephone Company, in federal court. We are pursuing a variety of contract, tort, antitrust and other claims, such as violations of the Telecommunications Act, in these proceedings. In November 1998, we prevailed in our commercial arbitration proceeding against Pacific Bell. The arbitration panel found that Pacific Bell breached its interconnection agreement with us and failed to act in good faith on multiple counts. The arbitration panel ruled in favor of awarding us direct damages, as well as attorneys' fees and costs of the arbitration. Pacific Bell is currently attempting to have the decision vacated. We have also filed a lawsuit against Bell Atlantic and its affiliates in federal court. We are pursuing antitrust and other claims in this lawsuit. In addition, Bell Atlantic has separately filed suit against us asserting at least one patent infringement claim. Failure to resolve the various legal disputes and controversies between us and the various traditional telephone companies without excessive delay and cost and in a manner that is favorable to us could harm our business.

We are not currently engaged in any other legal proceedings that we believe could have a material adverse effect on our business, prospects, operating results and financial condition. We are, however, subject to state commission, FCC and court decisions as they relate to the interpretation and implementation of the 1996 Telecommunications Act, the interpretation of competitive telecommunications company interconnection agreements in general and our interconnection agreements in particular. In some cases, we may be deemed to be bound by the results of ongoing proceedings of these bodies or the legal outcomes of other contested interconnection agreements that are similar to our agreements. The results of any of these proceedings could harm our business.

Item 2. Changes in Securities and Use of Proceeds

In June 1999, we issued 7,307,317 shares of common stock upon the exercise of warrants that were issued in connection with the offering of our 1998 notes. The issuance of these shares was pursuant to the "net exercise" of the warrants and, therefore, we received no cash proceeds from the issuance of the shares. The shares were issued in reliance on an exemption from registration under the Securities Act provided by Section 4(2) of such act and the rules and regulation promulgated thereunder.

Of these shares, 7,088,654 were sold by the holders in a registered public offering under the Securities Act that was underwritten by a syndicate of underwriters led by Bear, Stearns & Co. Inc, Morgan Stanley & Co. Incorporated, Credit Suisse First Boston Corporation, Deutsche Bank Securities Inc., Donaldson, Lufkin & Jenrette Securities Corporation and Wit Capital Corporation.

In January 1999, we commenced and completed a firm commitment underwritten initial public offering of 13,455,000 split-adjusted shares of our common stock, including 1,755,000 split-adjusted shares related to the

underwriter's over-allotment option, at a split-adjusted price of \$12.00 per share. The shares were registered with the Securities and Exchange Commission pursuant to a registration statement on Form S-1 (No. 333-63899), which was declared effective on January 21, 1999. The public offering was underwritten by a syndicate of underwriters led by Bear, Stearns & Co. Inc., BT Alex. Brown Incorporated, Donaldson, Lufkin & Jenrette Securities Corporation and Goldman, Sachs & Co., as their representatives. After deducting underwriting discounts and commissions of \$10.0 million and expenses of \$1.2 million, we received net proceeds of \$150.2 million.

As of June 30, 1999, we had invested the net proceeds from our initial public offering in short- and long-term investments in order to meet anticipated cash needs for future working capital. We invested our available cash principally in high-quality corporate issuers and in debt instruments of the U.S. Government and its agencies. The use of proceeds from the offering does not represent a material change in the use of proceeds described in the Registration Statement. None of the net proceeds of the offering were paid directly or indirectly to any director, officer, general partner of Covad or their associates, persons owning 10 percent or more of any class of equity securities of Covad, or an affiliate of Covad.

Item 6. Exhibits and Reports on Form 8-K

a. Exhibits:

<u>Exhibit Number</u>	<u>Description of Exhibit</u>
10.1	Note secured by Deed of Trust dated May 24, 1999 issued by Robert Davenport in favor of Covad Communications Group, Inc.
27.1	Financial Data Schedules for the six months ended June 30, 1999.

b. Reports on Form 8-K

There have been no reports on Form 8-K filed during the quarter ended June 30, 1999.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

COVAD COMMUNICATIONS GROUP, INC.

Date: August 16, 1999

By: /s/ Timothy P. Laehy
Timothy P. Laehy
Chief Financial Officer and Vice President, Finance
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

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REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

The Board of Directors and Stockholders of
Covad Communications Group, Inc.

We have audited the accompanying consolidated balance sheets of Covad Communications Group, Inc. as of December 31, 1997 and 1998, and the related consolidated statements of operations, stockholders' equity (net capital deficiency), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Covad Communications Group, Inc. as of December 31, 1997 and 1998, and the consolidated results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

/s/ ERNST & YOUNG LLP

San Jose, California
February 15, 1999

COVAD COMMUNICATIONS GROUP, INC.
CONSOLIDATED BALANCE SHEETS
(Amounts in 000's, except share and per share amounts)

	December 31,	
	1997 (Restated)(1)	1998
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 4,378	\$ 64,450
Accounts receivable, net of allowances for uncollectibles of \$0 and \$220.....	25	1,933
Unbilled revenue.....	4	663
Inventories.....	43	946
Prepaid expenses.....	52	1,183
Other current assets.....	317	514
Total current assets	4,819	69,689
Property and equipment:		
Networks and communication equipment.....	2,185	55,189
Computer equipment.....	600	4,426
Furniture and fixtures.....	185	1,119
Leasehold improvements.....	114	1,887
	3,084	62,621
Less accumulated depreciation and amortization.....	(70)	(3,476)
Net property and equipment	3,014	59,145
Other assets:		
Restricted cash.....	210	225
Deposits.....	31	337
Deferred debt issuance costs (net).....	—	8,112
Other long term assets.....	—	1,911
Total other assets	241	10,585
Total assets	\$ 8,074	\$ 139,419
LIABILITIES AND STOCKHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)		
Current liabilities:		
Accounts payable.....	\$ 651	\$ 14,975
Unearned revenue.....	7	551
Accrued network costs.....	58	1,866
Other accrued liabilities.....	77	3,854
Current portion of capital lease obligations.....	229	263
Total current liabilities	1,022	21,509
Long-term debt (net of discount).....	—	142,300
Long-term capital lease obligations.....	554	316
Total liabilities	1,576	164,125
Stockholders' equity (net capital deficiency):		
Convertible preferred stock (\$0.001 par value):		
Authorized shares—30,000,000		
Issued and outstanding shares—17,750,001 and 18,246,162 at December 31, 1997 and December 31, 1998, respectively.....	18	18
Common stock (\$0.001 par value):		
Authorized shares—65,000,000		
Issued and outstanding shares—11,361,204 and 11,773,997 at December 31, 1997 and December 31, 1998, respectively.....	11	12
Additional paid-in capital.....	9,692	30,685
Deferred compensation.....	(611)	(4,688)
Retained earnings (deficit).....	(2,612)	(50,733)
Total stockholders' equity (net capital deficiency)	6,498	(24,706)
Total liabilities and stockholders' equity (net capital deficiency)	\$ 8,074	\$ 139,419

(1) See Note 6.

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

CONSOLIDATED STATEMENTS OF OPERATIONS
(Amounts in 000's, except share and per share amounts)

	<u>Year Ended December 31,</u>	
	<u>1997</u>	<u>1998</u>
	(Restated)(1)	
Revenues.....	\$ 26	\$ 5,326
Operating expenses:		
Network and product costs.....	54	4,562
Sales, marketing, general and administrative	2,374	31,043
Amortization of deferred compensation.....	295	3,997
Depreciation and amortization.....	70	3,406
Total operating expenses	<u>2,793</u>	<u>43,008</u>
Income (loss) from operations.....	(2,767)	(37,682)
Interest income (expense):		
Interest income.....	167	4,778
Interest expense.....	(12)	(15,217)
Net interest income (expense).....	<u>155</u>	<u>(10,439)</u>
Net income (loss).....	<u>\$ (2,612)</u>	<u>\$ (48,121)</u>
Net income (loss) per common share.....	<u>\$ (0.80)</u>	<u>\$ (8.43)</u>
Weighted average shares used in computing net loss per share	3,271,546	5,708,535

(1) See Note 6.

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (NET CAPITAL DEFICIENCY)

(Restated)(1)

(Amounts in 000's, except share amounts)

	Convertible Preferred Stock		Common Stock		Additional Paid-In Capital	Deferred Compensation	Retained Earnings (Deficit)	Total Stockholders' Equity (Net Capital Deficiency)
	Shares	Amount	Shares	Amount				
Initial issuance of common stock	—	\$ —	12,000,000	\$ 12	\$ 38	\$ —	\$ —	\$ 50
Repurchase of common stock	—	—	(2,410,296)	(3)	(7)	—	—	(10)
Issuance of common stock	—	—	1,771,500	2	66	—	—	68
Issuance of Series A Preferred Stock	750,000	1	—	—	249	—	—	250
Issuance of Series B Preferred Stock (net of \$43 of financing costs)	17,000,001	17	—	—	8,440	—	—	8,457
Deferred compensation	—	—	—	—	906	(906)	—	—
Amortization of deferred compensation	—	—	—	—	—	295	—	295
Net loss	—	—	—	—	—	—	(2,612)	(2,612)
Balance at December 31, 1997	17,750,001	18	11,361,204	11	9,692	(611)	(2,612)	6,498
Issuance of common stock	—	—	412,793	1	570	—	—	571
Issuance of Series B Preferred Stock	100,002	—	—	—	100	—	—	100
Issuance of Series C Preferred Stock	396,159	—	—	—	1,100	—	—	1,100
Issuance of common stock warrants as part of debt offering issuance costs	—	—	—	—	2,928	—	—	2,928
Issuance of common stock warrants pursuant to debt offering	—	—	—	—	8,221	—	—	8,221
Deferred compensation	—	—	—	—	8,074	(8,074)	—	—
Amortization of deferred compensation	—	—	—	—	—	3,997	—	3,997
Net loss	—	—	—	—	—	—	(48,121)	(48,121)
Balance at December 31, 1998	<u>18,246,162</u>	<u>\$ 18</u>	<u>11,773,997</u>	<u>\$ 12</u>	<u>\$ 30,685</u>	<u>\$ (4,688)</u>	<u>\$ (50,733)</u>	<u>\$ (24,706)</u>

(1) See Note 6.

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Amounts in 000's)

	Year Ended December 31,	
	1997 (Restated)(1)	1998
Operating activities:		
Net loss	\$ (2,612)	\$(48,121)
Reconciliation of net loss to net cash provided by (used in) operating activities:		
Depreciation and amortization	70	3,406
Amortization of deferred compensation	295	3,997
Accreted interest and amortization of debt discount and deferred debt issuance costs	—	16,009
Net changes in current assets and liabilities:		
Accounts receivable	(25)	(1,908)
Inventories	(43)	(903)
Other current assets	(373)	(1,987)
Accounts payable	651	14,324
Unearned revenue	7	544
Other current liabilities	135	5,585
Net cash used in operating activities	(1,895)	(9,054)
Investing activities:		
Purchase of restricted cash	(210)	(15)
Deposits	(31)	(306)
Other long-term assets	—	(1,428)
Purchase of property and equipment	(2,253)	(59,503)
Net cash used in investing activities	(2,494)	(61,252)
Financing activities:		
Net proceeds from issuance of long-term debt and warrants	—	129,328
Principal payments under capital lease obligations	(48)	(238)
Proceeds from common stock issuance, net of repurchase	108	571
Proceeds from preferred stock issuance	8,707	1,200
Offering costs related to common stock offering	—	(483)
Net cash provided by financing activities	8,767	130,378
Net increase in cash and cash equivalents	4,378	60,072
Cash and cash equivalents at beginning of year	—	4,378
Cash and cash equivalents at end of year	<u>\$ 4,378</u>	<u>\$ 64,450</u>
Supplemental disclosures of cash flow information:		
Cash paid during the year for interest	\$ 9	\$ 99
Supplemental schedule of non-cash investing and financing activities:		
Equipment purchased through capital leases	\$ 831	\$ 34
Warrants issued for equity commitment	—	\$ 2,928

(1) See Note 6.

The accompanying notes are an integral part of these financial statements.

COVAD COMMUNICATIONS GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Nature of Operations and Summary of Significant Accounting Policies

Organization and Nature of Operations

Covad Communications Group, Inc. (the "Company") is a high-speed Internet and network access provider offering digital subscriber line ("DSL") services to Internet Service Provider ("ISP") and enterprise customers. ISPs purchase the Company's services in order to provide high-speed Internet access to their business and consumer end-users. Enterprise customers purchase the Company's services to provide employees with remote access to their Local Area Networks to improve employee productivity and reduce operating costs. The Company's services are provided over standard copper telephone lines at considerably faster speeds than available through a standard modem.

The Company's operations are subject to significant risks and uncertainties including competitive, financial, developmental, operational, growth and expansion, technological, regulatory, and other risks associated with an emerging business.

Summary of Significant Accounting Policies

A. Basis of Presentation

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements. Actual results may differ from those estimates.

The consolidated financial statements of the Company include the accounts of all of its wholly-owned subsidiaries. There were no intercompany accounts and transactions which required elimination.

The accompanying statements of operations, stockholders' equity, and cash flows for the year ended December 31, 1997 include \$50,000 received during 1996 upon issuance of the initial capital stock of the Company and \$2,000 expended in 1996 for general and administrative expenses. Due to the insignificance of balances at December 31, 1996 and activity for the period from inception through December 31, 1996, financial statements for 1996 have not been presented.

B. Revenue Recognition

Revenue related to installation of service and sale of customer premise equipment is recognized when equipment is delivered and installation is completed. Revenue from monthly recurring service is recognized in the month the service is provided. Recognized revenue for which the customer has not been billed is recorded as unbilled revenue until the period such billings are provided. Amounts billed in advance of providing services are recorded as unearned revenue until the period such services are provided. For the year ended December 31, 1998, one customer accounted for approximately 17% of the Company's revenue. For the year ended December 31, 1998, no other customer accounted for more than 10% of the Company's revenue.

C. Cash and Cash Equivalents

All highly liquid investments with a maturity of three months or less from the date of original issuance are considered to be cash equivalents.

D. Restricted Cash

As of December 31, 1997 and December 31, 1998, the Company had \$210,000 and \$225,000, respectively, in commercial deposits held in the Company's name but restricted as security for certain of the Company's capital lease arrangements.

E. Inventories

Inventories are stated at the lower of cost or market and consist primarily of customer premise equipment. Costs are based on the first-in first-out method.

F. Property and Equipment

Property and equipment are recorded at cost and depreciated using the straight-line method over the following estimated useful lives:

Leasehold improvements	15 years or life of the lease
Electronic communication equipment	2 to 5 years
Furniture and fixtures	3 to 7 years
Computer equipment	3 years
Office equipment	2 to 5 years
Computer software	2 to 7 years

The Company capitalizes costs associated with the design, deployment and expansion of the Company's network including internally and externally developed software. Capitalized external software costs include the actual costs to purchase software from vendors. Capitalized internal software costs generally include personnel and related costs incurred in the enhancement and implementation of purchased software packages. Capitalized internal labor costs for the years ending December 31, 1997 and December 31, 1998 were \$139,000 and \$3,063,000, respectively. Capitalized interest cost for the year ending December 31, 1998 was approximately \$900,000.

G. Equipment Under Capital Leases

The Company leases certain of its equipment and other fixed assets under capital lease agreements. The assets and liabilities under capital leases are recorded at the lesser of the present value of aggregate future minimum lease payments, including estimated bargain purchase options, or the fair value of the assets under lease, whichever is less. Assets under capital lease are amortized over the lease term or useful life of the assets.

H. Income Taxes

Due to the Company's overall loss position, there is no provision for income taxes for 1997 or 1998. The reconciliation of income tax computed at the US federal statutory rate to income tax expense is as follows:

	December 31,	
	1997	1998
Federal at 34%, statutory	\$ (757,000)	\$ (16,363,000)
Non deductible interest	—	911,000
Losses with no current benefit	757,000	15,436,000
Other	—	16,000
Provision	<u>\$ —</u>	<u>\$ —</u>

As of December 31, 1998, the Company had federal and state net operating loss carryforwards of approximately \$40,000,000. The net operating loss and credit carryforwards will expire at various dates beginning in 2005 through 2018, if not utilized.

The utilization of the net operating loss is subject to a substantial annual limitation due to the "change in ownership" provisions of the Internal Revenue Code of 1986 and similar state provisions. The annual limitation may result in the expiration of net operating losses and credits before utilization. Significant components of the Company's deferred tax assets and liabilities for federal and state income taxes are as follows:

	December 31,	
	1997	1998
Deferred tax assets:		
Net operating loss carryforwards	\$ 820,000	\$ 16,000,000
Depreciation	—	1,000,000
Other	—	1,500,000
Net deferred tax assets	820,000	18,500,000
Valuation allowance	(820,000)	(18,500,000)
Net deferred tax assets	<u>—</u>	<u>—</u>

The net valuation allowance increased by \$17,680,000 during the year ended December 31, 1998.

I. Fair Value of Financial Instruments

Statement of Financial Accounting Standards ("SFAS") No. 107, "Disclosures About Fair Value of Financial Instruments," as amended by SFAS No. 119, "Disclosures About Derivative Financial Instruments and Fair Value of Financial Instruments," requires disclosure of fair value information about financial instruments whether or not recognized in the balance sheet, for which it is practicable to estimate that value. In cases where quoted market prices are not available for identical or comparable financial instruments, fair values are based on estimates using the present value of estimated cash flows or other valuation techniques. The resulting fair values can be significantly affected by the assumptions used, including the discount rate and estimates as to the amounts and timing of future cash flows.

The following methods and assumptions were used to estimate the fair value for financial instruments:

Cash and cash equivalents. The carrying amount approximates fair value.

Borrowings. The fair values of borrowings, including long-term debt, capital lease obligations and other obligations, were estimated based on quoted market prices, where available, or by discounting the future cash flows using estimated borrowing rates at which similar types of borrowing arrangements with the same remaining maturities could be obtained by the Company. For all borrowings outstanding at December 31, 1997 and December 31, 1998, fair value approximates recorded value.

J. Earnings (Loss) Per Share

Basic earnings per share is computed by dividing income or loss applicable to common shareholders by the weighted average number of shares of the Company's common stock ("Common Stock"), after giving consideration to shares subject to repurchase, outstanding during the period.

Diluted earnings per share is determined in the same manner as basic earnings per share except that the number of shares is increased assuming exercise of dilutive stock options and warrants using the treasury stock method and conversion of the Company's convertible preferred stock ("Preferred Stock"). In addition, income or loss is adjusted for dividends and other transactions relating to preferred shares for which conversion is assumed. The diluted earnings per share amount has not been reported because the Company has a net loss and the impact of the assumed exercise of the stock options and warrants and the assumed preferred stock conversion is not dilutive.

Under the Company's Certificate of Incorporation, all outstanding Preferred Stock will convert into Common Stock on a one-for-one basis upon the completion of the Company's initial public offering of Common Stock (see note 9).

The consolidated financial statements applicable to the prior periods have been restated to reflect a two-for-one stock split effective May 1998 and a three-for-two stock split effective August 1998.

The following table presents the calculation of basic and diluted net income (loss) per share (in thousands, except share and per share amounts):

	<u>Year Ended December 31,</u>	
	<u>1997</u>	<u>1998</u>
Net income (loss).....	\$ (2,612)	\$ (48,121)
Basic and diluted:		
Weighted average shares of common stock outstanding.....	11,021,269	11,505,307
Less: Weighted average shares subject to repurchase.....	<u>7,749,723</u>	<u>5,796,772</u>
Weighted average shares used in computing basic and diluted net		
income (loss) per share.....	<u>3,271,546</u>	<u>5,708,535</u>
Basic and diluted net income (loss) per share.....	<u>\$ (0.80)</u>	<u>\$ (8.43)</u>

K. Concentration of Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company's cash and investment policies limit investments to short-term, investment grade instruments. Concentrations of credit risk with respect to accounts receivable are limited due to the large number of customers comprising the Company's customer base. In addition, the Company

typically offers its customers credit terms. The Company performs ongoing credit evaluations of its customers' financial condition and generally does not require collateral.

L. Key Suppliers

The Company is dependent on limited source suppliers for certain equipment used to provide its services. The Company has generally been able to obtain an adequate supply of equipment. In addition, the Company believes that there are alternative suppliers for the equipment used to provide its services. However, an extended interruption in the supply of equipment currently obtained from limited source suppliers could adversely affect the Company's business and results of operations.

M. Accounts Receivable Allowance:

The Company established a reserve for uncollectible accounts receivable in the amount of \$220,000 at December 31, 1998. No significant charges were made against this reserve as of December 31, 1998.

N. Recently Issued Accounting Pronouncements:

In June 1997, the Financial Accounting Standards Board issued Statement No. 131, "Disclosures About Segments of an Enterprise and Related Information" ("SFAS 131"), which establishes standards for the way that public business enterprises report information about operating segments in quarterly and annual financial statements. SFAS 131 changes segment reporting from an industry segment basis to an operating segment basis defined based on how the business is managed. The Company operates in only one segment, high-speed digital communications services, and hence, separate segment reporting is not applicable.

2. Debt

On March 11, 1998, the Company completed a private placement (the "1998 Private Offering") through the issuance of 260,000 units (the "Units"), each unit consisting of \$1,000 in principal amount at maturity of 13 $\frac{1}{2}$ % Senior Discount Notes due 2008 (the "Notes") and one warrant, initially exercisable to purchase 19.4376 shares of common stock, \$0.001 par value, of the Company (the "Unit Warrants"). Net proceeds from the 1998 Private Offering were approximately \$129.6 million, after transaction costs of approximately \$5.5 million.

The principal amount of the Notes will accrete from the date of issuance at the rate of 13 $\frac{1}{2}$ % per annum through March 15, 2003, compounded semi-annually, and thereafter bear interest at the rate of 13 $\frac{1}{2}$ % per annum, payable semi-annually, in arrears on March 15 and September 15 of each year, commencing on September 15, 2003. The Notes are unsecured senior obligations of the Company that will mature on March 15, 2008. The Notes will be redeemable at the option of the Company at any time after March 15, 2003 plus accrued and unpaid interest thereon, if any, to the redemption date.

The Notes were originally recorded at approximately \$126.9 million, which represents the \$135.1 million in gross proceeds less the approximate \$8.2 million value assigned to the Unit Warrants, which is included in additional paid-in capital. The value assigned to the Unit Warrants, representing debt discount, is being amortized over the life of the Notes. Debt issuance costs were incurred through the issuance of additional warrants associated with the commitment of equity by certain investors. The debt issuance costs are also being amortized over the life of the Notes. For the year ended December 31, 1998, the accretion of the Notes and the amortization of debt discount and debt issuance costs was \$16 million, of which \$15.1 million is included in interest expense and \$900,000 is capitalized in property, plant and equipment.

The Unit Warrants have ten year terms, have exercise prices of \$0.0033 per share (subject to adjustment in certain events), contain net exercise provisions and are currently exercisable.

3. Capital Leases

The Company has entered into capital lease arrangements to finance the acquisition of certain operating assets, two of which have bargain purchase options. The principal value of these leases totaled \$831,000 and \$865,000 as of December 31, 1997 and December 31, 1998, respectively, and was equivalent to the fair value of the assets leased.

Future minimum lease payments under capital leases are as follows:

<u>Year Ending December 31,</u>	
1999	335,000
2000	294,000
2001	44,000
2002	4,000
2003	—
Thereafter	—
	<u>677,000</u>
Less amount representing interest	(98,000)
Less current portion	<u>(263,000)</u>
Total long-term portion	<u>\$ 316,000</u>

Accumulated amortization for equipment under capital leases is reflected in accumulated depreciation and amortization for property and equipment.

4. Operating Leases

The Company leases vehicles, equipment, and office space under various operating leases. Future minimum lease payments by year under operating leases are as follows:

<u>Year Ending December 31,</u>	
1999	2,656,000
2000	2,105,000
2001	2,159,000
2002	1,436,000
2003	506,000
Thereafter	<u>351,000</u>
Total	<u>\$9,213,000</u>

Rental expense on operating leases totaled \$131,000 and \$1,507,000 for the year ended December 31, 1997 and December 31, 1998, respectively.

5. Stockholders' Equity

Covad Communications Group, Inc.

Common Stock:

The number of shares of Common Stock authorized for issuance by the Company is 65,000,000 shares with a par value of \$.001 per share. Shares of Common Stock outstanding at December 31, 1997 and December 31, 1998, were 11,361,204 and 11,773,997 shares,

respectively, of which 7,033,107 and 4,773,083 shares, respectively, remain subject to repurchase provisions which generally lapse over a four year period from the date of issuance.

Common Stock reserved for future issuance as of December 31, 1998 is as follows:

Convertible preferred stock	18,246,162
Outstanding and reserved options	15,306,843
Outstanding warrants	<u>6,988,764</u>
Total	<u>40,541,769</u>

Convertible Preferred Stock:

Convertible preferred stock consists of the following:

	<u>December 31,</u>	
	<u>1997</u>	<u>1998</u>
Authorized shares—30,000,000		
Series A preferred stock (\$0.001 par value):		
Authorized shares—750,000		
Issued and outstanding shares—750,000 at December 31, 1997 and December 31, 1998	\$ 1	\$ 1
Series B preferred stock (\$0.001 par value):		
Authorized shares—17,100,003		
Issued and outstanding shares—17,000,001 at December 31, 1997 and 17,100,003 at December 31, 1998	17	17
Series C preferred stock (\$0.001 par value):		
Authorized shares—11,149,287		
Issued and outstanding shares—None at December 31, 1997 and 396,159 at December 31, 1998		
	<u>\$ 18</u>	<u>\$ 18</u>

In January 1999, all of the outstanding convertible Preferred Stock converted into Common Stock (see Note 9).

Equity Commitment

On February 20, 1998, the Company entered into a Series C Preferred Stock and Warrant Subscription Agreement (the "Subscription Agreement") with certain of its investors (the "Series C Investors") pursuant to which the Series C Investors have unconditionally agreed to purchase an aggregate of 5,764,143 shares of Series C Preferred Stock and warrants to purchase an aggregate of 4,729,500 shares of Series C Preferred Stock (the "Series C Warrants") for an aggregate purchase price of \$16.0 million at a date to be determined by the Company but no later than March 11, 1999. The Company either has agreed to call the Equity Commitment or to complete an alternate equity financing of at least \$16.0 million by March 11, 1999. In consideration of this commitment, the Company has issued to the Series C Investors warrants to purchase an aggregate of 1,694,148 shares of the Company's Common Stock at a purchase price of \$0.0033 per share (the "Common Warrants"). In January 1999, the Company completed an alternative equity financing and, as a result, the Equity Commitment will not be called (see Note 9).

On April 24, 1998, the Subscription Agreement was amended pursuant to an Assignment and Assumption Agreement between the Company, the Series C Investors, and a director of the Company whereby the Series C Investors assigned to the director of the Company their obligation to purchase 36,015 shares of Series C Preferred Stock and 29,559 Series C Warrants for an

aggregate purchase price of \$100,000. On the same date, the director purchased 36,015 shares of Series C Preferred Stock. As a result of this amendment, the aggregate obligation of the Series C Investors to purchase Series C Preferred Stock and Series C Warrants was reduced from 5,764,143 shares to 5,728,128 shares, and from 4,729,500 shares to 4,699,941 shares, respectively, for an aggregate purchase price of \$15.9 million, reduced from \$16.0 million.

The Stock Purchase

On March 11, 1998, an investor in the Company purchased 360,144 shares of Series C Preferred Stock and Series C Warrants to purchase an aggregate of 295,500 shares of Series C Preferred Stock for an aggregate purchase price of \$1.0 million; provided, that the Company does not have any obligation to issue such Series C Warrants to this investor until such time as the Equity Commitment is called. In connection with its agreement to purchase such Series C Preferred Stock and Series C Warrants, the Company issued to this investor Common Warrants to purchase an aggregate of 105,852 shares of Common Stock at a purchase price of \$0.0033 per share.

Preferred Stock Dividends

The holders of Series A, Series B and Series C were entitled to receive in any fiscal year, dividends at the rate of \$0.0167 per share, \$0.04 per share and \$0.2233 per share, respectively, payable in preference and priority to any payment of dividends on Common Stock. The rights to such dividends were cumulative and accrue to the holders to the extent they were not declared or paid and were payable, in cash or Common Stock, only in the event of a liquidation, dissolution or winding up of the Company, or other liquidity event (as defined in the Certificate of Incorporation). The cumulative dividends at December 31, 1997 and December 31, 1998 for Preferred Stock were \$318,250 and \$1,084,740, respectively, none of which has been declared or paid.

6. Stock Options

In 1997, the Company adopted the Covad Communications Group, Inc. 1997 Stock Plan (the "Plan"). The Plan provides for the grant of stock purchase rights and options to purchase shares of Common Stock to employees and consultants from time to time as determined by the Board of Directors. The options expire from two to eight years after the date of grant. As of December 31, 1998 the Plan has reserved 15,520,342 shares of the Company's Common Stock for sale and issuance under the Plan at prices to be determined by the Board of Directors.

The following is a summary of the status of stock options outstanding at December 31, 1998:

<u>Exercise Price Range</u>	<u>Options Outstanding</u>			<u>Options Exercisable</u>	
	<u>Number of Shares</u>	<u>Weighted-Average Life Remaining</u>	<u>Weighted-Average Exercise Price</u>	<u>Number of Shares</u>	<u>Weighted-Average Exercise Price</u>
\$0.033-\$0.667	6,503,028	6.4 years	\$0.2675	1,775,834	\$0.1672
\$1.00-\$1.627	2,782,499	7.5 years	\$1.1538	46,870	\$1.6270
\$5.75	1,438,802	7.6 years	\$5.7500	4,372	\$5.7500
\$7.38-\$7.93	1,311,961	7.7 years	\$7.7741	8,066	\$7.6733
\$8.16	195,500	7.9 years	\$8.1600	500	\$8.1600

The following table summarizes stock option activity for the year ended December 31, 1997 and December 31, 1998:

	Number of Shares of Common Stock	Option Price Per Share		
Balance as of December 31, 1996	—	N/A		
Granted	3,843,750	\$0.033	-	\$0.05
Exercised.....	(6,000)			\$0.033
Forfeited.....	(33,000)	\$0.033	-	\$0.05
Balance as of December 31, 1997	3,804,750	\$0.033	-	\$0.05
Granted	9,358,978	\$0.10	-	\$8.16
Exercised.....	(207,499)	\$0.033	-	\$ 0.667
Forfeited.....	(724,439)	\$0.033	-	\$7.93
Balance as of December 31, 1998	12,231,790	\$0.033	-	\$8.16

The Company has elected to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," ("APB 25") and related interpretations in accounting for its employee stock options and the disclosure only provisions of SFAS No. 123, "Accounting and Disclosure of Stock-Based Compensation," ("SFAS 123"). Under APB 25, compensation expense is recognized based on the amount by which the fair value of the underlying common stock exceeds the exercise price of stock options at the date of grant. As a result of the Company's reassessment during 1998 of the fair values per share of its common stock, the Company has restated its financial statements for the year ended December 31, 1997 to record deferred compensation of \$906,000 as a result of granting stock options and issuing restricted stock with exercise or issue prices per share below the revised fair value per share of the Company's common stock at the date of grant or issuance. This amount was recorded as a reduction of stockholders' equity and is being amortized as a charge to operations over the vesting period of the applicable options. Such amortization was \$295,000 for the year ended December 31, 1997. During the year ended December 31, 1998, the Company recorded additional deferred compensation of approximately \$8.1 million. Amortization of deferred compensation during this same period was approximately \$4.0 million.

Stock-Based Compensation

Pro forma information regarding results of operations and loss per share is required by SFAS 123 as if the Company had accounted for its stock-based awards under the fair value method of SFAS 123. The fair value of the Company's stock-based awards to employees has been estimated using the minimum value option pricing model which does not consider stock price volatility. Because the Company does not have actively traded equity securities, volatility is not considered in determining the fair value of stock-based awards to employees.

For the year ended December 31, 1997 and December 31, 1998, the fair value of the Company's stock-based awards to employees was estimated using the following weighted average assumptions:

	1997	1998
Expected life of options in years	4.0	4.0
Risk-free interest rate.....	7.0 %	7.0 %
Expected dividend yield.....	0.00%	0.00%

The weighted average fair value of stock options granted during the year ended December 31, 1997 and December 31, 1998 was \$0.26 and \$2.05 per share, respectively. For pro

forma purposes, the estimated fair value of the Company's stock-based awards to employees is amortized over the options' vesting period which would result in an increase in net loss of approximately \$12,000 and \$1.7 million for the year ended December 31, 1997 and 1998, respectively. The result of applying SFAS 123 to the Company's option grants was not material to the results of operations or loss per share for the year ended December 31, 1997 and would have increased the net loss per share by \$0.30 per share for the year ended December 31, 1998.

7. Related Party Transactions

The Company purchases equipment from a supplier which is partially owned by an investor in the company. Purchases from this supplier totaled \$85,000 and \$5.8 million for the years ending December 31, 1997 and December 31, 1998, respectively.

8. Legal Proceedings

The Company is engaged in a variety of negotiations, arbitrations and regulatory and court proceedings with incumbent local exchange carriers ("ILECs"). These negotiations, arbitrations and proceedings concern the ILECs' denial of physical collocation space to the Company in certain central offices, the cost and delivery of collocation spaces, the delivery of transmission facilities and telephone lines, billing issues and other operational issues. None of these actions involve a potential liability for the Company. However, failure to resolve any of these matters without undue delay or expense could have a material adverse effect on the Company's business, prospects, operating results and financial condition. The Company is not currently engaged in any other legal proceedings that it believes could have a material adverse effect on the Company's business, prospects, operating results and financial condition. The Company is, however, subject to state commission, FCC and court decisions as they relate to the interpretation and implementation of the Telecommunications Act of 1996, the interpretation of competitive local exchange carrier interconnection agreements in general and the Company's interconnection agreements in particular. In some cases, the Company may be deemed to be bound by the results of ongoing proceedings of these bodies or the legal outcomes of other contested interconnection agreements that are similar to the Company's agreements. The results of any of these proceedings could have a material adverse effect on the Company's business, prospects, operating results and financial condition.

9. Subsequent Events

In January 1999, the Company entered into strategic relationships with AT&T Corp. ("AT&T"), NEXTLINK Communications, Inc. ("NEXTLINK") and Qwest Communications Corporation ("QCC"). As part of these strategic relationships, the Company received equity investments of \$25 million from AT&T's venture capital arm and two affiliated funds, \$20 million from NEXTLINK and \$15 million from QCC's wholly owned subsidiary, U.S. Telesource, Inc. (as used herein, "Qwest" refers to QCC or its subsidiary, as applicable). The Company intends to record intangible assets of \$28.7 million associated with these transactions. Furthermore, AT&T, NEXTLINK and Qwest each entered into commercial agreements with the Company providing for the purchase, marketing and resale of the Company's services, the purchase by the Company of fiber optic transport bandwidth, and collocation of network equipment. In addition, the equity investments by AT&T, NEXTLINK and Qwest satisfied the conditions of an alternate equity financing and thus the Equity Commitment will not be called.

On January 27, 1999, the Company completed the Initial Public Offering ("IPO") of 8,970,000 shares of Common Stock at a price of \$18.00 per share. Net proceeds to the Company

from the IPO were \$150.2 million after deducting underwriting discounts and commissions and estimated offering expenses payable by the Company. As a result of the IPO, all shares of Preferred Stock, including shares issued in the above-mentioned strategic transactions, were converted into Common Stock, all cumulative but unpaid dividends on Series A and Series B were paid in Common Stock and the Common Warrants were exercised.

On February 11, 1999, the Company issued 12½% Senior Notes due February 15, 2009 through a private placement. Interest is due and payable in cash on February 15 and August 15 of each year, beginning on August 15, 1999. Net proceeds to the Company were approximately \$205.4 million after discounts and transaction costs of approximately \$9.6 million. Approximately \$74.0 million of the net proceeds will be used to purchase pledged securities representing sufficient funds to pay the first six scheduled interest payments on the notes.

EXHIBIT 4

Core Management Team

Robert E. Knowling, Jr. President and Chief Executive Officer

Robert E. Knowling Jr. is Covad's President and Chief Executive Officer. He is responsible for all aspects of Covad's national roll-out as well as the day-to-day operations of the business.

Mr. Knowling comes to Covad from U S WEST where he was the Executive Vice President of Operations and Technologies. His 30,000-member team was responsible for planning, delivering and maintaining high-quality telecommunications services for more than 25 million customers in 14 states. Knowling joined U S WEST in March 1996 as Vice President of Network Operations.

Knowling began his career in 1977 at Indiana Bell and progressed rapidly through a variety of assignments in operations, engineering and marketing. When Indiana Bell became a part of Ameritech, Knowling assumed positions of increasing responsibility in marketing, product development, large business marketing and network operations. He was assigned to Ameritech's re-engineering breakthrough development team in 1992. As the lead architect of the Ameritech transformation, Knowling reported directly to the chairman. He was named vice president of Network Operations for Ameritech in 1994.

Knowling has received many business and community service awards during his career. These include the Personal Achievement in Business Award from the Center for Leadership Development, the Dr. Martin Luther King Jr. Drum Major Instinct Award in the Business from the Frontiers International Association, and the Outstanding Service Award for the YMCA of the USA. He was named a Denver "Father of the Year" by the Juvenile Diabetes Foundation.

A *Newsweek* article about customer service referred to him as U S WEST's "Mr. Fix-it." Articles in *Training, Inc.* and *Fast Company* magazines featured him and his role as an aggressive and successful change agent. *Fast Company* profiled his change-management process in a full-length story written by Dr. Noel Tichy, a distinguished professor at the University of Michigan Graduate School of Business.

In addition, Knowling was featured in a new book, also by Tichy, "The Leadership Engine — How Successful Companies Build Leaders at Every Level." He is profiled as one of the nation's business' role model leaders.

Knowling serves on the boards of directors for several business and civic organizations, including the Corporate Board of Directors of Shell Oil, Exploration and Production Company. Knowling has been a YMCA volunteer for more than 15 years and served as chair of the National Services group for the YMCA in 1993. He maintains an active nationwide corporate and public speaking schedule.

Knowling received a bachelor of arts degree from Wabash College and a master of business administration from Northwestern University's Kellogg Graduate School of Business. He and his wife have three daughters and one son.

Charles J. McMinn
Chairman of the Board

Charles McMinn has over twenty years of experience in creating, financing, operating, and advising high technology companies.

In the last several years he has focused almost exclusively on information technology and communications businesses. During this time Mr. McMinn wrote the business plan, developed the financial plan and was the first outside investor in Internet in a Mall, an Internet Service Provider in Tarzana, California that has grown to over twenty thousand subscribers in one year. Mr. McMinn also rewrote the operating plan, provided strategic planning assistance and invested in The Fourth Network, Inc., a company which designs, installs, and operates Internet access servers for hotel guests.

Through consulting work with Gemini Consulting, Regis McKenna, Inc., and his own consulting business, Cefac Consulting, Mr. McMinn has also provided advice to large information technology companies. Mr. McMinn led a team of consultants to define a strategy for Lucent, Intel and Broadband Technologies to accelerate the deployment of Fiber to the Curb technology by the Regional Bell Operating Companies. He also provided advice to Ameritech on the market and business strategy for Asynchronous Digital Subscriber Loop (ADSL) data services. Mr. McMinn also developed the strategy and business economics for a Satellite Multimedia Data Delivery Service for a Fortune 25 technology company, defined a spinout business opportunity for a company with Digital Simultaneous Voice and Data (DSVD) modem technology and recommended a new product strategy for the high speed video networking subsidiary of a large graphics company.

Mr. McMinn's prior consulting work also included providing general management, new product planning and engineering strategy help for a market leading desktop video editing equipment company and defining marketing strategy, determining market segmentation and conducting marketing focus groups for a startup desktop video teleconferencing company employing wavelet technology.

Mr. McMinn also has extensive operating experience in high technology companies. From 1992 to 1993 Mr. McMinn was the first President and CEO of Visioneer Communications. He joined this four-person seed funded company investigating new data input devices for personal computers. He focused the company's strategy through over 50 end customer feedback meetings, wrote the Business Plan, raised \$5.5M in venture capital, hired 4 vice presidents, grew the organization to 20 people in six months and secured a manufacturing partner for the company. Visioneer Communications had its Initial Public Offering (IPO) in December 1995.

Mr. McMinn has also held marketing and engineering roles in Silicon Valley companies including Director of Engineering and Director of Marketing for Megatest Corporation, a venture backed startup in the Semiconductor Test Equipment business. Mr. McMinn began his Silicon Valley career as the product manager of the 8086 microprocessor at Intel Corporation. While at Intel Mr. McMinn also served in several other Strategic Planning and Marketing Management roles.

Mr. McMinn also has extensive venture capital experience in financing Silicon Valley startups. From 1986 to 1992 Mr. McMinn was a General Partner at InterWest Partners, a venture capital

partnership located in Menlo Park, CA. While at InterWest Mr. McMinn was responsible for all aspects of the venture capital investment process for early stage technology companies. Mr. McMinn identified and invested in six high technology startups that returned over \$25M in profit. He participated actively in all six investments, serving on the Board of Directors of five. He served as the lead investor and board member in Radius, Inc., the first Macintosh graphics and desktop video company. Radius grew from less than \$1M to over \$150M and a successful public offering. Mr. McMinn participated in the decision process for all InterWest III and IV investments, a 60 company portfolio that has returned over \$150M in realized capital gains.

Mr. McMinn graduated magna cum laude from Brown University in 1974 with a BSEE. He received his MSEE from Syracuse University in 1976, and his MBA from Harvard Business School in 1978, where he was a Baker Scholar graduate.

Dhruv Khanna
Executive Vice President and General Counsel

Dhruv Khanna has been a practicing attorney for more than 10 years, specializing in telecommunications law, regulation and public policy as well as business transactions involving the Regional Bell Operation Companies (RBOCs) and other telecommunications companies. He has represented such clients as Cable & Wireless, Intel Corporation, McCaw Cellular Communications, Southern Pacific Telecom, and Teleport Communications Group at more than 10 different state regulatory commissions, the Federal Communications Commission and the OFTEL. Mr. Khanna's communications law practice has included landline and wireless service issues and has involved local and long distance service providers. His practice has included efforts to open telecommunications markets to competition, obtain certificates and interconnection arrangements for local exchange competitors.

In addition to telecommunications matters, Mr. Khanna's practice has included both civil litigation and commercial transactions. His litigation experience has included prosecuting fraud, breach of contract, and tort cases for individuals, small and large businesses, and prosecuting, and defending against, appeals at the California Supreme Court and other courts. His transactional experience has included drafting and negotiating agreements with such companies as AT&T, Bell Atlantic, BellSouth, Compaq, Ericsson, IBM, NEC, NYNEX, Pacific Bell, and U S WEST. In addition, his transactional experience includes start-up company practice and commercial transactions that run the gamut from purchase and sales, co-marketing and technology licensing agreements.

Mr. Khanna was involved in efforts on behalf of Intel Corporation to shape various provisions of the Federal Telecommunications Act of 1996. He has been at the forefront of computer industry and consumer group efforts against ISDN rate increases proposed by various RBOCs. Mr. Khanna has been Senior Communications Attorney at Intel Corp., and has also been the counsel for Intel's faxmodem, videoconferencing and Internet-related product lines. He has been the counsel for Intel's Corporate Business Development group, focusing on business arrangements involving the RBOCs and business opportunities created by the Telecommunications Act of 1996.

Mr. Khanna graduated from Dartmouth College in 1983, obtaining a Bachelor of Arts degree, with a double major in Economics and Government. He graduated from Stanford Law School with a JD in 1986. Mr. Khanna was previously an associate at Morrison & Foerster.

Partial list of Mr. Khanna's conference appearances and publications:

1. University of Oregon School of Law, Innovation and the Information Environment Conference, "Structural Regulation of the Telecommunications Industry: National and International Consequences of a Global Network." Eugene, Oregon, November 3, 1995.
2. ALTS Conference. "The CLEC Industry's Opportunities to Serve the Unmet Demand for High-Bandwidth Services." San Francisco, May 2, 1996.
3. Telecommunications Reports Conference, "The Economic, Technical and Regulatory Aspects of Interconnection." Washington D.C., June 18, 1996.

4. One ISPCON. "Telco Regulation: Boon or Bust for ISPs." San Francisco, August 9, 1996.
5. Next-Generation Telephony, Telecommunications Reports Conference. "The Internet and Telecom Regulatory and Policy Issues," Washington, D.C., October 24, 1996
6. Oregon Law Review, Spring 1996, Vol. 75, No. 1. "The Public's Need for More Affordable Bandwidth: The Case for Immediate Regulatory Action." Dhruv Khanna and Bruce M. Aitken.

Chuck Haas
Executive Vice President, Sales

Chuck Haas was at Intel Corporation for over fourteen years. He has been a Manager with Intel's Corporate Business Development, focusing on opportunities in the broadband computer communications area. He has been responsible for creating new business initiatives and establishing externally focused business relationships in the field of residential broadband connections to the PC; from the formation of strategic alliances with major corporations to equity participation in early stage companies. He has played a principal role in the development of the company's Residential Broadband strategy for telephone and satellite companies (xDSL/Fiber-to-the-Curb and satellite modems). He has been involved in market and technical trials with cable modems, and the full range of computer communications hardware and infrastructure from POTS modems, to ISDN and beyond.

On behalf of Intel, Mr. Haas negotiated the conduct of a market trial for cable modems with BellSouth, and has otherwise had significant experience in negotiating agreements with communication service providers including cable system operators such as Continental Cablevision, Cox and Comcast. He has also had significant experience in negotiating a variety of commercial agreements with small and large vendors of telecommunications equipment vendors such as Lucent Technologies and Hybrid Networks. Mr. Haas was involved in design wins for Intel's semiconductor products into virtually all state-of-the-art communications equipment, including: wireless switches, 5ESS central office switches, 4ESS toll office switches, digital cross-connects, PBXs and SONET lightwave transmission equipment.

Mr. Haas joined Intel in 1982 as a Technical Sales Engineer, moving two years later to the position of Field Applications Engineer. In 1986 he became Sales Engineer for the AT&T account. Mr. Haas was named District Sales Manager for the AT&T account in 1990.

In 1993 he was appointed Manager of Intel's NCCI (New Computer and Communication Industry) programs reporting to Intel Senior Vice President of Corporate Strategy, prior to assuming his current position in 1995.

Mr. Haas graduated from Virginia Tech with a Bachelor of Science degree in Computer Science in 1982.

Partial list of Mr. Haas' conference appearances:

1. National Communications Forum. "Intranet: The Company Network of Choice" Chicago, October 16, 1996
2. SuperComm '96. Executive Panel. June 25, 1996
3. SuperComm '96. "Unraveling Residential Broadband". June 26, 1996.
4. SuperComm '96. "The Connected PC: User Platforms for Megabit Copper Access Networks". June 26, 1996
5. Paul Kagen Conference. 1995

Technical Management

Thomas J. Regan Director of Collocation

Thomas J. Regan is the Director of Collocation Operations of Covad Communications Company and DIECA. Prior to joining Covad, Mr. Regan was employed at Pacific Bell for 27 years. At Pacific Bell, his most recent position was Expanded Interconnection Service Product Manager, reporting to the Executive Director. In this capacity, Mr. Regan managed a 300% increase in interconnection service requests in 1996. He was responsible for the statewide management of Pacific Bell's offering and implementation of physical collocation by Competitive Local Exchange Carriers (CLECs) of their own CLEC equipment in Pacific Bell's Central Offices.

Mr. Regan directed Pacific Bell's collocation teams involving personnel from Pacific Bell's Operations, Engineering, Real Estate and Security departments. He prepared Pacific Bell's complete market financial package for the FCC's and CPUC's regulatory approvals on each request for new Central Offices and new interconnection products, as well as related tariffs. In addition, Mr. Regan managed Pacific Bell's collocation and billing and account crediting process for collocating CLECs.

Prior to commencing his role as product manager for collocation and expanded interconnection at Pacific Bell, Mr. Regan was a senior engineer for Pacific Bell responsible for a variety of large-scale network engineering projects. He participated in the deployment of new switch-based products and developed new processes to facilitate the introduction of new products throughout the Bay Area.

His significant projects include leading the implementation of 15 major Advance Digital Technology projects; coordinating the engineering and provisioning of customer requests for large Centrex, Centrex-IS, PRI ISDN, Voice Mail, SDS 56 and other tariffed products; and coordinating Pacific Bell's engineering and operations activities to deploy major new network products, serving as the Network Technology Department's point of contact for field trials and first office applications of new switch technology.

In addition, Mr. Regan previously served as Pacific Bell's Service Manager for Bank of America's account in San Francisco between 1986 and 1990. He was responsible for ensuring Bank of America's satisfaction with all voice and data services which included 63 data networks, three data centers, two alarm centers, a merchant services center, a business service center and a money transfer center. He completed several key voice and data projects for Bank of America, including the six phase ATM, alarm consolidation, point-of-sale transfer, circuit inventory, identification and rehome for north and south locations, fiber surveillance, and ADN on the California Data Network, and reduced error rates on the Bank of America voice network and converted it from analog to digital statewide, and improved its point of sale network capabilities and efficiency.

Prior to 1986, Mr. Regan's positions at Pacific Bell included the following: Customer Service Supervisor; Division Staff Training Facilitator; Distribution Services, Installation and Prewire Supervisor; and Distribution Services Cutover Supervisor.

**Catherine Hemmer
President, Operations**

As Vice President of Operations, Catherine Hemmer is responsible for delivering consistent, high-quality services and support to Covad customers and their subscribers. Network Operations, Field Operations and Customer Care report to Ms. Hemmer. She joins the Company with an extensive background in operations, corporate planning and management information systems within the telecommunications industry. Most recently, Ms. Hemmer was Vice President of network reliability and operations for U S WEST. Prior to joining U S WEST, Ms. Hemmer was General Manager of network provisioning at Ameritech Services, Inc. and, before that, Vice President of network services for MFS Telcom, Inc. She has also held management posts with Chicago Fiber Optic Corporation and MCI Telecommunications Corporation.

Rex Cardinale
Vice President, Engineering

As Covad's Vice President of engineering, Rex Cardinale is responsible for the design of Covad's network architecture and operations support systems. Previously, Mr. Cardinale served as CEO and Vice President of engineering at GlobalCenter Inc., an Internet service provider for small businesses. He created the GlobalCenter business as a division of Global Village Communication, where he served as Vice President and General Manager. Before this, Mr. Cardinale was Vice President and General Manager of the cc:Mail division of Lotus Development Corporation and was Vice President of engineering for Ultra Network Technologies, a provider of high-speed networking systems for supercomputers. He also spent 10 years with Rolm Corporation in various engineering management roles. Mr. Cardinale has a B.S. degree in Electrical Engineering and Computer Science from the University of Santa Clara.

EXHIBIT 5

**REGULATIONS GOVERNING THE
PROVISION OF DEDICATED SERVICES
FOR CONNECTION TO PUBLIC AND PRIVATE
COMMUNICATIONS FACILITIES WITHIN
THE STATE OF TENNESSEE**

Issued:

Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Effective:

CHECK SHEET

The pages of this draft tariff are effective as of the date shown. The original and revised sheets named below contain all changes from the original draft tariff and are in effect on the date shown.

<u>SHEET</u>	<u>REVISION</u>
1	Original
2	Original
3	Original
4	Original
5	Original
6	Original
7	Original
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Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

CHECK SHEET

(continued)

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Effective:

Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

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Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Effective:

PRELIMINARY STATEMENT

This draft tariff sets forth the service offering, rates, terms and conditions applicable to the furnishing of local services and special access services (including high capacity and other private line services) by DIECA Communications, Inc. in the State of Tennessee.

The rates, rules, terms and conditions herein apply for service provided throughout the service area of DIECA Communications, Inc. as defined in this draft tariff.

The rates and rules contained herein are subject to change pursuant to the rules and regulations of the Tennessee Regulatory Authority.

This draft tariff shall be maintained in its currently effective form and made available for inspection by any Customer at DIECA Communications, Inc.'s business office, c/o Covad Communications Company, at 2330 Central Expressway, Santa Clara, CA 95050. DIECA Communications, Inc. shall hereinafter sometimes be referred to as the Company.

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Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Effective:

1. **EXPLANATION OF SYMBOLS, REFERENCE MARKS, AND
ABBREVIATIONS OF TECHNICAL TERMS USED IN THIS DRAFT
TARIFF**

The following symbols shall be used in this draft tariff for the purposes indicated below:

- (C) To signify a changed regulation.
- (D) To signify discontinued rate or regulation.
- (I) To signify an increased rate.
- (M) To signify a move in the location of text.
- (N) To signify a new rate or regulation.
- (R) To signify a reduced rate.
- (K) To signify that material has been transferred to another sheet or place on the draft tariff.
- (T) To signify a change in text but no change in rate or regulation.
- (O) To signify no change.

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DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Effective:

2. DEFINITIONS

Certain terms used generally throughout this draft tariff are described below.

Access Lines: A Telephone facility which permits access to and from both the Customer's premises and the telephone exchange or serving central office.

Add/Drop Multiplexing: A multiplexing function that allows lower level signals to be added or dropped from an Optical Carrier (OC) channel.

Agent: A business representative, whose function is to bring about, modify, affect, accept performance of, or terminate contractual obligations between a CLC, its applicants or Customers.

Applicant: A person who applies for telecommunications service. Includes persons seeking reconnection of their service after Company-initiated termination.

Application: A request made orally or in writing for telecommunications service.

Auxiliary Line Service: Auxiliary line service is additional individual line service furnished to supplement the main individual line service of a Customer.

Building: A structure under one roof and of such a nature that it can in itself fulfill the requirements of a business or residence establishment, or both; or two or more structures that are connected by means of enclosed passageways (overhead bridges, subways, or a ground level) or common basements, permitting access from one building to the other, that are suitable for the routing, placing, and proper protection of inside cable and wire type facilities. In no case can conduit be considered an enclosed passageway.

Business Service: Determination as to whether or not Customer's service should be classified as Business Service will be based on the character or use to be made of the service. The practice of advertising a telephone number in newspapers, business cards, or on trucks shall be a contributing, but not an exclusive factor in determining the classification of service. Service will be classified as Business service where the use is primarily or substantially of a business, professional, institutional, or otherwise occupational nature.

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2330 Central Expressway, Santa Clara, CA 95050

Central Office Area: The area within which Customers' lines are connected to the central office established by the Company to serve that area. More than one central office may be located in the same building.

Central Office: A switching unit in a telephone system which provides service to the general public, having the necessary equipment and operating arrangements for terminating and interconnecting Customer lines and trunks or trunks only. There may be more than one central office in a building or exchange.

Channel: A path (or paths) for electrical communication between two or more stations or telephone company offices and furnished in such a manner as the telephone company may elect.

Class of Service: The various categories of service generally available to the Customer, such as business, residential, public or semipublic service.

Company: DIECA Communications, Inc.

Connecting Arrangement: The equipment provided by the Company to accomplish the direct connection of Customer-provided facilities with the facilities of the Company; or facilities of the Company with other facilities of the Company.

Cost: The cost of labor and materials, which includes appropriate amounts to cover the Company's general operating and administrative expenses.

Construction Charge: A separate nonrecurring charge made for the construction of facilities in excess of those contemplated under the rates quoted in this draft tariff.

Continuous Property: Continuous property is defined as plot of ground, together with any buildings thereon, occupied by the Customer; which is not separated by public thoroughfares or by property occupied by others.

Contract: The agreement between a Customer and the Company under which service and facilities are furnished in accordance with the applicable provisions of the draft tariffs.

Customer: A person, firm or corporation which orders service and is responsible for the payment of charges and compliance with terms and conditions of this draft tariff.

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DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Customer-Provided Equipment: All communications systems, devices, apparatus and their associate wiring, provided by Customer.

Date of Presentation: Postmark date on billing envelope.

Disconnect Notice: The written notice sent to a Customer following billing, notifying him that his service will be discontinued if charges are no satisfied by the date specified on the notice.

Draft Tariff: The rates, charges, rules and regulations adopted and filed by the Company with the TRA.

Drop Wire: Wires between an open wire lead or aerial or underground cable terminal and the point of entrance to the premises in which the Customer's telecommunications service is located. The drop wire terminates in the protector or its equivalent.

End Office: The term "end office" denotes the LEC switching system office or serving wire center where Customer station loops are terminated for purposes of interconnection to each other and/or to trunks.

Entrance Facilities: Facilities extending from the point of entrance on private property to the premises on which service is furnished.

Facilities: Includes, in the aggregate or otherwise, but is not limited to, the following:

channels	lines
apparatus	devices
equipment	accessories
communications paths	systems

which are provided by the Company and utilized by it in the furnishing of telecommunications services or which are provided by a Customer and used for telecommunications purposes.

Facilities-Based CLC: A CLC which directly owns controls, operates, or manages conduits, ducts, poles, wires, cables, instruments, switches, appurtenances, or appliances in connection with or to facilitate communications within the local exchange portion of the public switched network.

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Effective:

Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Fiber Optic Cable: A thin filament of glass with a protective outer coating through which a light beam carrying communications signals may be transmitted by means of multiple internal reflections to a receiver, which translates the message.

Individual Case Basis (ICB): A service arrangement in which the regulations, rates and charges are developed based on the specific circumstances of the case.

Installation Charge: A nonrecurring charge made at the time of installation of communications service which may apply in place of or in addition to service charges and other applicable charges for service or equipment.

Interface: The term "Interface" denotes that point on the premises of the Customer at which provision is made for connection of other than Company provided facilities to facilities provided by the Company.

Interface Equipment: Equipment provided by the Company at the interface location to accomplish the direct electrical connection of facilities provided by the Company with facilities provided by other than the Company.

Interface Jack: A connecting device provided for use as a point of demarcation between network access service and Customer-owned equipment.

Kbps: Kilobits per second, denotes thousands of bits per second.

LEC: LEC (local exchange carrier) refers to the dominant local exchange carrier in an area also served by the Company.

Maintenance Visit Charge: A charge applied when the location of reported trouble is found to be in Customer-provided equipment.

Mbps: Megabits per second, denotes millions of bits per second.

Mileage: The measurement upon which charges are computed for line extensions.

Minimum Contract Period: The minimum length of time for which a Customer is obligated to pay for service, facilities and equipment whether or not retained by the Customer for such minimum length of time.

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DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

Node: Any Company or Customer location that is capable of performing Add/Drop Multiplexing.

Nonfacilities-Based CLC: A CLC which does not directly own, control, operate, or manage conduits, ducts, poles, wires, cables, instruments, switches, appurtenances, or appliances in connection with or to facilitate communications within the local exchange portion of the public switched network.

Nonrecurring Charge: A one-time charge associated with a specific item of equipment or service. This charge applies to installation and to subsequent modifications.

NSF Check: Any negotiable instrument returned by a bank, savings institution or other eligible institution which is returned by that institution with one of the following instructions: non-sufficient funds, uncollectible funds, account closed, account frozen, no account.

Person: A natural person, firm partnership, corporation, association, municipality, cooperative, organization, government agency, real estate trust, or other legal entity.

Point of Demarcation: A point in a Customer's circuit to which the Company is responsible for service and beyond which the Customer is responsible for service.

Port: A facility or equipment systems or subsystem set aside for the sole use of a specific Customer.

Premises: The space occupied by a Customer or authorized user in a building or buildings on continuous property.

Recurring Charge: A monthly charge to the Customer for services, facilities and equipment, which continues for the duration of the service.

Registered Equipment: Equipment which complies with and has been approved within the registration provisions of Part 68 of the Federal Communications Commission's Rules and Regulations.

Residence Service: Service where the business use, if any, is merely incidental and where the major use is of a social or domestic nature.

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2330 Central Expressway, Santa Clara, CA 95050

Service Connection Charge: The nonrecurring charge a Customer is required to pay at the time of the establishment of telecommunications service or subsequent additions to that service.

Service Order: The written request for the Company's services executed by the Customer and the Company in a format devised by the Company. The signing of a Service Order form by the Customer and acceptance by the Company initiates the respective obligations of the parties as set forth therein and pursuant to this draft tariff.

Serving Wire Center: A serving wire center denotes the wire center from which the Customer designated premises would normally obtain dial tone from the Company.

Standard Network Interface: The point where Company network services or facilities terminate and the Company's responsibility for installing and maintaining such services or facilities ends.

Termination: Permanent disconnection of telecommunications service.

Termination Charge: A charge applied under certain conditions when a contract for service is terminated by the Customer before the expiration of the minimum contract period.

TRA: Tennessee Regulatory Authority.

Issued:

Issued By: Dhruv Khanna, VP & General Counsel
DIECA Communications, Inc.
2330 Central Expressway, Santa Clara, CA 95050

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3. APPLICATION OF DRAFT TARIFF

This draft tariff applies to intrastate access service supplied to Customers for origination and termination of traffic to and from Central Office codes directly assigned to the Company.

This draft tariff applies only to the extent that services provided hereunder are used by a Customer for the purpose of originating or terminating intrastate communications. A communication is "intrastate" only if all points of origination and termination are located within the State of Tennessee.

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4. REGULATIONS

4.1 Undertaking of the Company

4.1.1 Scope

The Company undertakes to furnish communications service pursuant to the terms of this draft tariff in connection with one-way and/or two-way information transmission between points within the State of Tennessee.

Customers and users may use services and facilities provided under this draft tariff to obtain access to services offered by other service providers. The Company is responsible under this draft tariff only for the services and facilities provided hereunder, and it assumes no responsibility for any service provided by any other entity that purchases access to the Company network in order to originate or terminate its own services, or to communicate with its own customers.

4.1.2 Shortage of Equipment or Facilities

- A) The Company reserves the right to limit or to allocate the use of existing facilities, or of additional facilities offered by the Company, when necessary because of a lack of facilities, or due to any other cause beyond the Company's control.
- B) The Company will provide service within 300 feet from the area abutting its transmission facilities as defined within.
- C) The furnishing of all other service under this draft tariff is subject to the availability on a continuing basis of all the necessary facilities and is limited to the capacity of the Company's facilities as well as facilities the Company may obtain from other carriers to furnish service from time to time as required at the sole discretion of the Company.

4.1.3 Terms and Conditions

- A) Service is provided on the basis of a minimum period of at least one month, 24-hours per day. For the purpose of computing charges in this draft tariff, a month is considered to have 30 days.
- B) Persons desiring to obtain the Company's service may do so by completing the Company's standard Service Order form or forms or by oral agreement.

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An Applicant for service must pay all previous indebtedness to the Company for telecommunications services before service will be furnished. Failure to pay for business service shall not constitute sufficient cause for refusal of residence service and failure to pay for residence service shall not constitute sufficient cause for refusal of business service.

An application for service becomes a contract upon the signing of the Company's Service Order form or by oral mutual agreement. Neither the contract nor any rights acquired thereunder may be assigned or in any manner transferred.

- C) During the initial contact all Applicants for residential service must be given information regarding the Universal Lifeline program and its availability.

Service shall be initiated based on a written or oral agreement between the CLC and the Applicant. In either case, prior to the agreement, the Applicant shall be informed of all rates and charges for the services the Applicant desires and any other rates or charges which will appear on the Customer's first bill.

If the agreement is oral, within ten (10) days of initiating the service order, the Company will provide a confirmation letter setting forth a brief description of the services ordered and itemizing all charges which will appear on the Customer's bill. The letter shall be in a language other than English if the sale was in such other language.

Within ten (10) days of the initiation of service, the Company shall state in writing for all new Customers all material terms and conditions that could affect what the Customer pays for telecommunications services provided by the Company.

Applicants who are denied service for failure to establish credit as described in Rule 6 shall be given the reason for the denial in writing within ten (10) days of service denial.

- D) Except as otherwise provided, the initial (or minimum) period for all services and facilities is one (1) month at the same location. Customers

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may terminate service at any time by providing the Company notice, and all recurring charges shall be prorated to the date of disconnection of service.

The length of contract period for directory listings, and for joint user service, where the listing actually appears in the directory, is the directory period. The directory period is from the day on which the directory is first distributed to the Customers to the day the succeeding directory is first distributed to Customers.

The Company may require a contract period longer than one (1) month at the same location in connection with Business Service and special (nonstandard) types of arrangements of equipment, or for unusual construction, necessary to meet special demands and involving extra costs.

4.1.4 Customer Responsibilities

The Customer shall be responsible for:

- A) The payment of all applicable charges as set forth in this draft tariff.
- B) Damage or loss of the Company's facilities or equipment caused by the acts or omissions of the Customer or authorized user, the noncompliance by the Customer or authorized user with these regulations; or by fire or theft or other casualty on the premises of the Customer or authorized user unless caused by the negligence or willful misconduct of the employee or agents of the Company.
- C) Providing as specified from time to time by the Company any needed personnel, equipment, space and power to operate Company facilities and equipment installed on the premises of the Customer or authorized user and the level of heating and air conditioning necessary to maintain the proper environment on such premises.
- D) Obtaining, maintaining, and otherwise having full responsibility for all rights of way and conduit necessary for installation of facilities and associated equipment used to provide Service to the Customer or authorized user from the point of entry to the termination point of the Customer's premises. Any and all costs associated with the obtaining and maintaining of the rights of way described herein, including the costs of altering the structure to permit installation of the Company provided facilities, shall be borne entirely by, or may be charged by, the Company to the Customer. The Company may require the Customer to

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demonstrate its compliance with this section prior to accepting an order for service.

- E) Providing a safe place to work and complying with all laws and regulations regarding the working conditions on the premises at which Company employees and agents shall be installing or maintaining the Company's facilities and equipment. The Customer may be required to install and maintain Company facilities and equipment within a hazardous area if harm to the Company's employees or property might result from installation or maintenance by the Company.
- F) Complying with all laws and regulations applicable to, and obtaining all consents, approvals, licenses and permits as may be required with respect to, the location of Company facilities and equipment in any Customer premises or the rights-of-way for which the Customer is responsible, and obtaining permission for Company agents or employees to enter the premises of the Customer or authorized user at any reasonable hour for the purpose of installing, inspecting, repairing, or, upon termination of service as stated herein, removing the facilities or equipment of the Company.
- G) Making Company facilities and equipment available periodically for maintenance purposes at a time agreeable to both the Company and the Customer. No allowance will be made for the period during which service is interrupted for such purposes.
- H) Keeping the Company's equipment and facilities located on the Customer's premises or rights-of-way obtained by the Customer free and clear of any liens or encumbrances relating to the Customer's

4.1.5 Limitations on Liability

- A) The provisions of this rule do not apply to errors and omissions caused by willful misconduct, fraudulent conduct or violations of law.
- B) The Company will not provide a credit allowance for interruptions of service caused by the customer's facilities, equipment, or systems.
- C) The following allowances are provided for interruptions in service, as specified for particular services furnished solely by the Company.

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- a. The Company shall allow, for interruptions in service of 24 hours or more not due to conduct of the customer, an amount equal to the pro rata charges for each 24-hour period, or major fraction thereof after the initial period or interruption in the following services:

(1) Mobile telecommunications service.

(2) Private line services and channels, as follows:

Private line telecommunications service.¹

Private line teletypewriter and Morse services.¹

Channels for data transmission.¹

Channels for remote metering, supervisory control and miscellaneous signaling purposes.¹

Continuous time announcement service.¹

Channels for one-way speech networks in connection with loudspeakers.²

Channels for one-way program transmission networks in connection with loudspeakers.²

- b. The Company shall allow for interruptions in exchange telecommunications service of 24 hours or more not due to conduct of the customer an amount equal to the fixed monthly charges for exchange service multiplied by the ratio of the days of interruption to thirty days. When interruptions continue beyond 24 hours, credit allowance will be given in successive 24-hour multiples.

NOTE 1: The allowance applies only to service within the same exchange area.

NOTE 2: The allowance applies only to station equipment and/or channel facilities.

c. RESERVED

- d. The Company shall allow for interruptions of 30 minutes or more not due to conduct of the customer (including authorized users) an amount equal to the pro rata charges in half-hour multiples for each 30-minute period or major fraction thereof after the initial period, of interruption in the following private line services and channels:

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- (1) Private Line telecommunications service.
 - (2) Private line teletypewriter and Morse Services.
 - (3) Channels for data transmission.
 - (4) Channels for remote metering, supervisory control and miscellaneous signaling purposes.
 - (5) Continuous Time Announcement Service.
 - (6) Channels for the remote operation of private mobile radio-telephone systems.
 - (7) Channels for one-way speech networks in connection with loudspeakers.
 - (8) Channels for one-way program transmission networks in connection with loudspeakers.
 - (9) Special assembly services and channels for miscellaneous experimental purposes.

The allowance on (1) preceding applies only to full period service. The allowance on Items (1) through (6) preceding applies only to service between separate exchange areas. The allowance on (8) and (9) preceding applies only to interexchange and interdistrict channels.

- e. The Company shall allow for interruptions of 30 seconds or more not due to conduct of the customer or failure of facilities provided by the customer an amount equal to the pro rata charges in five-minute multiples for each five-minute period or major fraction thereof of interruption in the following private line services and channels.

- (1) Channels for program transmission in connection with loudspeakers, sound reproduction or sound recording.
- (2) Channels for video transmission in connection with television viewers.

- f. The Company shall allow for interruptions of short period private line telecommunications service which aggregate one-sixth or more of the daily contract service not due to conduct of the customer (including authorized users) an amount equal to the pro rata charges for the period of interruption (excluding lost time made up later in the same day at the customer's request).
- g. The Company shall allow for interruptions of two consecutive hours or more not due to conduct of the customer or failure of facilities provided by the customer an amount equal to $1/720$ of the fixed monthly charge for each hour or major fraction thereof of interruption in private line channels for television transmission for use in educational television systems.
- h. The Company shall allow an amount calculated as shown in (2) below, for interruptions in Digital Service based on the Average Station Value, as defined in (1) below, and the length of the interruption, not due to conduct of the customer or authorized user or failure of facilities provided by the customer or authorized user or due to the failure of the customer to authorize replacement of any element of special construction. The period during which no credit allowance will be made shall begin on the seventh day after the customer receives the Company's notification of the need for such replacement and shall end on the day after the Company receives the customer's authorization for such replacement.

(1) Average Station Value

The average station value is calculated by dividing the total monthly charge for a service by the total number of stations on the service. The total monthly charge shall be comprised of all charges associated with the service, including charges for all equipment assigned to all Digital Station Terminals on the service.

(2) Credit Allowances for Interruptions

For the purpose of determining the amount of allowance every [*49] month is considered to have 30 days and only those stations on the

interrupted portions of a service shall be considered in determining the number of stations affected.

- An interruption credit allowance is determined by (i) calculating the Average Station Value for one full day (Average Station Value divided by 30 (days)) (ii) multiplying the result of (i) by the "credit" as specified following then (iii) multiplying the result of (ii) by the number of stations affected.

- Interruptions of 24 Hours or Less

Length of Interruption	Credit
Less than 30 minutes	None
30 minutes up to but not including 3 hours	1/10 day
3 hours up to but not including 6 hours	1/5 day
6 hours up to but not including 9 hours	2/5 day
9 hours up to but not including 12 hours	3/5 day
12 hours up to but not including 15 hours	4/5 day
15 hours up to 24 hours inclusive	One day

Two or more interruptions of 30 minutes or more during any period up to but not including 3 hours, shall be considered as an interruption.

-Interruptions Over 24 Hours

Credit will be allowed in 1/5 day multiples for each 3 hour period of interruption or fraction thereof. No more than one full day's credit will be allowed for any period of 24 hours.

- i. For purposes of these regulations, an interruption is deemed to exist from the time it is reported to or detected by the Company.
- D) Temporary Suspension for Repairs - The Company shall have the right to make necessary repairs or changes in its facilities at any time and will have the right to suspend or interrupt service temporarily for the purpose of making the necessary repairs or changes in its system. When such suspension or interruption of service for any appreciable period is necessary, the Company will give the customers who may be affected as reasonable notice thereof as circumstances will permit, and will prosecute

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the work with reasonable diligence, and if practicable at times that will cause the least inconvenience.

When the Company is repairing or changing its facilities, it shall take appropriate precautions to avoid unnecessary interruptions of conversations or customer's service.

These allowances are not to be construed as exclusive remedies.

4.1.6 Provision of Equipment and Facilities

- A) Except as otherwise indicated, customer-provided station equipment at the Customer's premises for use in connection with this service shall be so constructed, maintained and operated as to work satisfactorily with the facilities of the Company.
- B) The Company shall not be responsible for the installation, operation or maintenance of any Customer-provided communications equipment. Where such equipment is connected to service furnished pursuant to this draft tariff, the responsibility of the Company shall be limited to the furnishing of services under this draft tariff and to the maintenance and operation of such services in the proper manner. Subject to this responsibility, the Company shall not be responsible for:
 - 1) the through transmission of signals generated by Customer-provided equipment or for the quality of, or defects in, such transmission; or
 - 2) the reception of signals by Customer-provided equipment; or
 - 3) network control signaling where such signaling is performed by Customer-provided network control signaling equipment.

4.1.7 Non-Routine Installation

At the Customer's request, installation and/or maintenance may be performed outside the Company's regular business hours or in hazardous locations. In such cases, charged based on cost of the actual labor, material, or other costs incurred by or charged to the Company will apply. If installation is started during regular business hours but, at the Customer's request, extends beyond regular business

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hours into time periods including, but not limited to, weekends, holidays, and/or night hours, additional charged may apply.

4.1.8 Special Construction

Subject to the agreement of the Company and to all of the regulations contained in this draft tariff, special construction of facilities may be undertaken on a reasonable efforts basis at the request of the Customer. Special construction is that construction undertaken:

- A) where facilities are not presently available, and there is no other requirement for the facilities so constructed
- B) of a type other than that which the Company would normally utilize in the furnishing of its services;
- C) over a route other than that which the Company would normally utilize in the furnishing of its services;
- D) in a quantity greater than that which the Company would normally construct;
- E) on an expedited basis;
- F) on a temporary basis until permanent facilities are available;
- G) involving abnormal costs; or
- H) in advance of its normal construction.

4.1.9 Ownership of Facilities

Title to all facilities provided in accordance with this draft tariff remains in the Company, its agents or contractors. The Customer shall not have, nor shall it assert, any right, title or interest in all the fiber optic or other facilities and associated equipment provided by the Company hereunder.

4.1.10 Universal Emergency Telephone Number Service

- A) This draft tariff does not provide for the inspection or constant monitoring of facilities to discover errors, defects or malfunctions in the service, nor does the Company undertake such responsibility.

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- B) 911 information consisting of the names, addresses and telephone numbers of all telephone customers is confidential. The Company will release such information via the Data Management System only after a 911 call has been received, on a call by call basis, only for the purpose of responding to an emergency call in process.
- C) The 911 calling party, by dialing 911, waives the privacy afforded by non-listed and non-published service to the extent that the telephone number, name, and address associated with the originating station location are furnished to the Public Safety Answering Point.
- D) After the establishment of service, it is the Public Safety Agency's responsibility to continue to verify the accuracy of and to advise the Company of any changes as they occur in street names, establishment of new streets, changes in address numbers used on existing streets, closing and abandonment of streets, changes in police, fire, ambulance or other appropriate agencies' jurisdiction over any address, annexations and other changes in municipal and county boundaries, incorporation of new cities or any other similar matter that may affect the routing of 911 calls to the proper Public Safety Answering Point.
- E) The Company assumes no liability for any infringement, or invasion of any right of privacy or any person or persons caused, or claimed to be caused, directly or indirectly by the use of 911 Service. The Public Safety Agency agrees, except where the events, incidents, or eventualities set forth in this sentence are the result of the Company's gross negligence or willful misconduct, to release, indemnify, defend and hold harmless the Company from any and all loss or claims whatsoever, whether suffered, made, instituted, or asserted by the Public Safety Agency or by any other party or person, for any personal injury to or death of any person or persons, or for any loss, damage, or destruction of any property, whether owned by the customer or others. The Public Safety Agency also agrees to release, indemnify, defend and hold harmless the Company infringement of invasion of the right to privacy of any person or persons, caused or claimed to have been caused, directly or indirectly, by the installation, operation, failure to operate, maintenance, removal, presence, condition, occasion, or use of 911 Service features and the equipment associated therewith, or by any services furnished by the Company in connection therewith, including, but not limited

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to, the identification of the telephone number, address, or name associated with the telephone used by the party or parties accessing 911 Service hereunder, and which arise out of the negligence or other wrongful act of the Public Safety Agency, its user, agencies or municipalities, or the employees or agents of any one of them, or which arise out of the negligence, other than gross negligence or willful misconduct, of the Company, its employees or agents.

4.2 Prohibited Uses

- A) The services the Company offers shall not be used for any unlawful purpose or for any use as to which the Customer has not obtained all governmental approvals, authorizations, licenses, consents and permits required to be obtained by the Customer with respect thereto.
- B) The Company may require applicants for service who intend to use the Company's offerings for resale and/or for shared use to file a letter with the Company confirming that their use of the Company's offerings complies with relevant laws and TRA regulations, policies, orders, and decisions.
- C) The Company may, without obtaining any further consent from the Customer, assign any rights, privileges, or obligations under this draft tariff. The Customer shall not, without prior written consent of the Company, which consent shall not be unreasonably withheld, assign, transfer, or in any other manner dispose of, any of its rights, privileges, or obligations under this draft tariff, and any attempt to make such an assignment, transfer, disposition without consent shall be null and void.
- D) A Customer may not use the services so as to interfere with or impair service over any facilities and associated equipment, or so as to impair the privacy of any communications over such facilities and associated equipment. The Company may require a Customer to shut down its transmission of signals individually if said transmission is causing interference to others.
- E) Customer use of any resold service obtained from other service providers shall also be subject to any applicable restrictions in the underlying providers' publicly available draft tariffs.
- F) A Customer or authorized user shall not represent that its services are provided by the Company, or otherwise indicate to its Customers that its provision of services is jointly with the Company, without the written consent of the

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Company. The relationship between the Company and Customer shall not be that of partners or agents for one or the other, and shall not be deemed to constitute a partnership or agency agreement.

4.3 Obligations of the Customer

The Customer shall be responsible for:

- A) The payment of all applicable charges as set forth in this draft tariff.
- B) Damage or loss of the Company's facilities or equipment caused by the acts or omissions of the Customer or authorized user, the noncompliance by the Customer or authorized user with these regulations; or by fire or theft or other casualty on the premises of the Customer or authorized user unless caused by the negligence or willful misconduct of the employee or agents of the Company.
- C) Providing as specified from time to time by the Company any needed personnel, equipment, space and power to operate Company facilities and equipment installed on the premises of the Customer or authorized user and the level of heating and air conditioning necessary to maintain the proper environment on such premises.
- D) Obtaining, maintaining, and otherwise having full responsibility for all rights of way and conduit necessary for installation of facilities and associated equipment used to provide Service to the Customer or authorized user from the point of entry to the termination point of the Customer's premises. Any and all costs associated with the obtaining and maintaining of the rights of way described herein, including the costs of altering the structure to permit installation of the Company provided facilities, shall be borne entirely by, or may be charged by, the Company to the Customer. The Company may require the Customer to demonstrate its compliance with this section prior to accepting an order for service.
- E) Providing a safe place to work and complying with all laws and regulations regarding the working conditions on the premises at which Company employees and agents shall be installing or maintaining the Company's facilities and equipment. The Customer may be required to install and maintain Company facilities and equipment within a hazardous area if harm to the Company's employees or property might result from installation or maintenance by the Company.

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- F) Complying with all laws and regulations applicable to, and obtaining all consents, approvals, licenses and permits as may be required with respect to, the location of Company facilities and equipment in any Customer premises or the rights-of-way for which the Customer is responsible, and obtaining permission for Company agents or employees to enter the premises of the Customer or authorized user at any reasonable hour for the purpose of installing, inspecting, repairing, or, upon termination of service as stated herein, removing the facilities or equipment of the Company.
 - G) Making Company facilities and equipment available periodically for maintenance purposes at a time agreeable to both the Company and the Customer. No allowance will be made for the period during which service is interrupted for such purposes.
 - H) Keeping the Company's equipment and facilities located on the Customer's premises or rights-of-way obtained by the Customer free and clear of any liens or encumbrances relating to the Customer's use of the Company's services or from the locations of such equipment and facilities.

4.3.1 Liability of the Customer

- A) The Customer will be liable for damages to the facilities of the Company and for all incidental and consequential damages caused by the negligent or intentional acts or omissions of the Customer, its officers, employees, agents, invitees, or contractors where such acts or omissions are not the direct result of the Company's negligence or intentional misconduct.
- B) To the extent caused by any negligent or intentional act of the Customer as described in (A), preceding, the Customer shall indemnify, defend and hold harmless the Company from and against all claims, actions, damages, liabilities, costs and expenses, including reasonable attorney's fees, for (1) any loss, destruction or damage to property of any third party, and (2) any liability incurred by the Company to any third party pursuant to this or any other draft tariff of the Company, or otherwise, for any interruption of, interference to, or other defect in any service provided by the Company to such third party.
- C) The Customer shall not assert any claim against any other customer or user of the Company's services for damages resulting in whole or in part from

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or arising in connection with the furnishing of service under this draft tariff including but not limited to mistakes, omissions, interruptions, delays, errors or other defects or misrepresentations, whether or not such other customer or user contributed in any way to the occurrence of the damages, unless such damages were caused solely by the negligent or intentional act or omission of the other customer or user and not by any act or omission of the Company. Nothing in this draft tariff is intended either to limit or to expand Customer's right to assert any claims against third parties for damages of any nature other than those described in the preceding sentence.

4.4 Customer Equipment and Channels

4.4.1 General

A User may transmit or receive information or signals via the facilities of the Company. The Company's services are designed primarily for the transmission of voice-grade telephone signals, except as otherwise stated in this draft tariff. A User may transmit any draft of signal that is compatible with the Company's equipment, but the Company does not guarantee that its services will be suitable for purposes other than voice-grade telephonic communications except as specifically stated in this draft tariff.

4.4.2 Station Equipment

- A) Customer provided terminal equipment on the premises of the Customer or authorized user, the operating personnel there, and the electric power consumed by such equipment shall be provided by and maintained at the expense of the Customer or authorized user. Conformance of Customer-provided station equipment with Part 68 of the FCC Rules is the responsibility of the Customer.
- B) The Customer or authorized user is responsible for ensuring that Customer-provided equipment connected to Company equipment and facilities is compatible with such equipment and facilities. The magnitude and character of the voltages and currents impressed on Company provided equipment and wiring by the connection, operation, or maintenance of such equipment and wiring shall be such as not to cause damage to the Company provided equipment and wiring or injury to the Company's employees or to

other persons. Any additional protective equipment required to prevent such damage or injury shall be provided by the Company at the Customer's expense.

4.4.3 Interconnection of Facilities

- A) Any special interface equipment necessary to achieve compatibility between the facilities and equipment of the Company used for furnishing Communications Services and the channels, facilities, or equipment of others shall be provided at the Customer's expense.
- B) Communications Services may be connected to the services or facilities of other communications carriers only when authorized by, and in accordance with, the terms and conditions of the draft tariffs of the other communications carriers which are applicable to such connections.
- C) Facilities furnished under this draft tariff may be connected to customer provided terminal equipment in accordance with the provisions of this draft tariff. All such equipment shall be registered by the Federal Communications Commission pursuant to Part 68 of Title 47, Code of Federal Regulations; and all User-provided wiring shall be installed and maintained in compliance with those regulations.
- D) Users may interconnect communications facilities that are used in whole or in part for intrastate communications to services provided under this draft tariff only to the extent that the user is an "end user" as defined in Section 69.2(m), Title 47, Code of Federal Regulations (1992 edition).

4.4.4 Inspections

- A) Upon suitable notification to the Customer, and at a reasonable time, the Company may make such tests and inspections as may be necessary to determine that the Customer, authorized user, or joint user is complying with the requirements set forth above for the installation, operation and maintenance of Customer-provided facilities, equipment, and wiring in the connection of Customer-provided facilities and equipment to Company owned facilities and equipment.

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- B) If the protective requirements for Customer-provided equipment are not being complied with, the Company may take such action as it deems necessary to protect its facilities, equipment, and personnel. The Company will notify the Customer promptly if there is any need for further corrective action. Within (10) days of receiving this notice, the Customer must take such action. If the Customer fails to do this, the Company may take whatever additional action is deemed necessary, including the suspension of service, to protect its facilities, equipment, and personnel from harm.

4.5.1 Advance Payments

To safeguard its interests, the Company may require a Customer to make an advance payment before services and facilities are furnished. The advance payment will not exceed an amount up to two months of estimated monthly usage charges. In addition, where special construction is involved, the advance payment may also include an amount equal to the estimated non-recurring charges for the special construction and recurring charges (if any) for a period to be set between the Company and the Customer. The advance payment will be credited to the Customer's initial bill. An advance payment may be required in addition to a deposit.

4.5.2 Deposits

The Company does not require a deposit payment to provide service.

4.6 Payment Arrangements

4.6.1 Payments for Service

The Customer is responsible for the payment of all charges for facilities and services furnished by the Company to the Customer.

4.6.2 Billing and Collection of Charges

The Customer is responsible for payment of all charges for facilities and services furnished, including charges for services originated, or charges accepted, at such facilities. This Customer responsibility also includes charges associated with the fraudulent use of facilities and services by the Customer or any end users of the Customer's service. All bills are payable at the Company's business offices.

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- A) At such time as the Company completes installation or connection of the necessary facilities and/or equipment to provide services the Company shall conduct appropriate tests thereon. Upon successful completion of such tests, the Company shall notify the Customer that such services, are available for use, and the date of such notice shall be called the "Service Date" and shall be the starting date for billing.
- C) Customer shall pay the amounts as specified in the draft tariff for the Services. Nonrecurring charges, including construction, are due in advance. Fixed recurring charges shall be billed in advance after the Service date is determined and will be due no later than thirty (30) days after the date the invoice was presented to Customer. Variable recurring charges and other charges shall be billed as incurred, and will be due no later than thirty (30) days after the date the invoice was presented to Customer. Any amount not received within said fifteen (15)-day period will be subject to the Company's standard late payment charge specified in Section 4.6.2 F), below. Customer agrees to review each invoice promptly and to notify the Company of any discrepancies within one hundred and eighty (180) days of receipt of each invoice.
- D) Any prorated bill shall use a thirty (30)-day month to calculate the pro-rata amount. Prorating shall apply only to recurring charges. All nonrecurring and usage charges incurred during the billing period shall be billed in addition to prorated amounts.
- E) Recurring charges for all services are billed monthly, in advance, for one (1) month's minimum charge
- F) Bills are due and payable on the date of presentation. A late payment charge, as described below, will be applied if payment is not received by the utility on or before the late payment date which date will be prominently displayed on the Customer's bill. The late payment date will be at least fifteen (15) days after the date of presentation on the billing envelope. The Company shall credit payments within twenty-four (24) hours of receipt to avoid assessing late payment charges incorrectly.

A late payment charge of 1.5% applies to each Customer's bill when the previous month's bill has not been paid in full within fifteen (15) days after presentment of the bill, leaving an unpaid balance carried forward. The percentage late payment charge is applied to the total unpaid amount carried forward and is included in the total amount due on the current bill.

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If payment for a current bill is received by the Company before the bill's due date, but for technical or other reasons the payment is not applied to the Customer's account prior to the issuance of a subsequent bill, the Customer shall not be liable for that portion of any unpaid balance attributed to a Late Payment Charge.

A Customer shall not be liable for any Late Payment Charge applicable to a disputed portion of that Customer's bill, so long as the Customer pays the undisputed portion of the bill and enters into bona fide negotiations to resolve the dispute on a timely basis.

- G) Checks presented in payment for services and subsequently returned to the Company of the Customer's financial institution for "Non-Sufficient Funds" or other reasons will incur a nonrecurring charge per Customer, per check:

Per Returned Check

\$20.00

A Customer will be placed on a "cash only" basis upon receipt of two (2) returned checks within a twelve (12)-month period of time. "Cash only" is herein defined as cashier's checks, U.S. currency, or money orders.

Receipt of a subsequently dishonored negotiable instrument in response to a notice of discontinuance shall not constitute payment of a Customer's account and the Company will not be required to issue additional notice prior to discontinuance. However, three (3) banking days must be allowed for redemption of such instrument.

- H) Notices to discontinue service for nonpayment of bills shall be provided in writing by first class mail to the Customer not less than seven (7) calendar days prior to termination. Each notice shall include all of the following information:
1. The name and address of the Customer whose account is delinquent.
 2. The amount that is delinquent.
 3. The date when payment or arrangements for payment are required in order to avoid termination.
 4. The procedure the Customer may use to initiated complaint or to request an investigation concerning service or charges.

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5. The procedure the Customer may use to request amortization of the unpaid charges.
6. The telephone number of a representative of the Company, who can provide additional information or institute arrangements for payment.
7. The telephone number of the TRA's Consumer Affairs Branch.
8. Local service may not be discontinued for nonpayment of charges for Category III or other unregulated competitive services.

4.6.3 Billing Disputes

A) General

All bills are presumed accurate, and shall be binding on the Customer unless notice of the disputed charge(s) is received by the Company. For the purposes of this section, "notice" is defined as verbal or written notice to the Company, containing sufficient documentation to investigate the dispute, including the account number under which the bill has been rendered, the date of the bill, and the specific terms on the bill being disputed.

B) Late Payment Charges

The undisputed portions of the bill must be paid by the payment due date to avoid assessment of a late payment charge on the undisputed amount under Section 4.6.2(E), preceding.

C) Adjustments or Refunds to the Customer

- 1) In the event that the Company resolves the billing dispute in favor of a Customer who has withheld payment of the disputed amount pending resolution of the disputed bill, the Company will credit the Customer's account for the disputed amount in the billing period following the resolution of the dispute.
- 2) In the even that the Company resolves the billing dispute in favor of a Customer who has paid the total amount of the disputed bill, the

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Company will credit the Customer's account for any overpayment by the Customer in the billing period following the resolution of the dispute.

- 3) In the event that the Company resolves the billing dispute in favor of a Customer who has paid the total amount of the disputed bill but canceled the service, the Company will issue a refund of any overpayment by the Customer.

D) Unresolved Billing Disputes

- 1) In the case of a billing dispute between Customer and the Company for service furnished to the Customer, which cannot be settled to the mutual satisfaction of the Customer and the Company, the Customer should request the Company to provide an in-depth review of the disputed amount.
- 2) If after investigation and review by the Company, a disagreement remains as to the disputed amount, the Customer may file an appropriate complaint with:

Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37243
(800) 342-8359

4.6.4 Discontinuance of Service for Cause

The Company shall, upon reasonable notice, when it can be reasonably given, have the right to suspend or curtail or discontinue service for the following reasons:

- A) For the purpose of making permanent or temporary repairs, changes or improvements in any part of its system;
- B) For compliance in good faith with any governmental order or directive notwithstanding such order or directive subsequently may be held to be invalid;
- C) For any of the following acts of omissions on the part of the Customer:

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- (i) Nonpayment of a valid bill due for service furnished at a present or previous location. The customer(s) of record whose name(s) appear on the bill shall be held responsible for utility service rendered. However, nonpayment for business service shall not be a reason for discontinuance of residential service, except in cases of diversion of service, and service shall not be discontinued for nonpayment of repair charges, merchandise charges, installation of conservation measures and other non-tariff contracted service charges between the customer and the Company, nor shall notice threatening such discontinuance be given;
 - (ii) Tampering with the facility of the Company;
 - (iii) Fraudulent representation in relation to the use of service;
 - (iv) Customer moving from the premises, unless the customer requests that the service be continued;
 - (v) Providing a Company's service to others without approval of the Company;
 - (vi) Failure to make or increase an advance payment or deposit as provided for in these rules or the Company's draft tariff;
 - (vii) Refusal to contract for service where such contract is required;
 - (viii) Connecting and operating in such manner as to produce disturbing effects on the service of the Company or other customers;
 - (ix) Failure of the customer to comply with any reasonable standard terms and conditions contained in the Company's draft tariff;
 - (x) Where the condition of the customer's installation presents a hazard to life or property;
 - (xi) Failure of customer to repair any faulty facility of the customer.
- D) Notice of the proposed discontinuance is provided pursuant to the rules listed within.
- E) Service is not initially discontinued on any Saturday, Sunday, legal holiday, or any other day Company representatives are not available to serve Customers.

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- F) For refusal of reasonable access to customer's premises for necessary purposes in connection with rendering of service, including meter installation, reading or testing, or the maintenance or removal of the Company's property.
- G) Notice of Discontinuance
- 1) The Customer shall be given a period of at least fifteen (15) days for payment after the postmark date indicated on the envelope in which the bill was transmitted. In the absence of a postmark, the burden of proving the date of mailing shall be upon the Company. When a customer mails any payment for the net amount of a bill for service, and such payment is received at the Company's office not more than two full business days after the due date printed on the bill, the Customer shall be deemed to have made timely payment. A public utility may discontinue service for non-payment of bills provided it gives the customer, at least ten (10) days written notice of its intention to discontinue. The notice of discontinuance shall not be served until the expiration of the said fifteen (15) day period. A new notice shall be served by the Company each time it intends to discontinue service for nonpayment of a bill except that no additional notice shall be required when, in response to a notice of discontinuance, payment by check is subsequently dishonored. However, in the case of fraud, illegal use, or when it is clearly indicated that the customer is preparing to leave, immediate payment of accounts may be required.
- (a) telephone public utilities shall annually notify all residential customers that, upon request, notice of discontinuance of service will be sent to a designated third party as well as to the customer.
- (b) Telephone public utilities shall make good faith efforts to determine which of their residential customers are over 65 years of age, and shall make good faith efforts to notify such customers of discontinuance of service by telephone in addition to notice by regular mail. This effort may consist of an appropriate inquiry set forth in the notice informing customers that they may designate a third party to receive notice of discontinuance. This provision shall not apply to utilities which make good faith efforts to contact all residential customers by

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telephone prior to discontinuance and file with the TRA a statement setting forth such procedure.

- 2) When the customer is a public utility under the TRA's jurisdiction, the serving utility shall concurrently serve a copy of the notice of discontinuance on the TRA.
- 3) On all notices of discontinuance to residential customers, there shall be included:
 - (a) A statement that the Company is subject to the jurisdiction of the TRA and the address and telephone number of the TRA.
 - (b) A statement that in the event the customer is either unable to make payment of a bill or wishes to contest a bill the customer should contact the Company. The notice shall contain information sufficient for the customer to make appropriate inquiry.
 - (c) A statement that if a customer is presently unable to pay an outstanding bill, the customer may contact the Company to discuss the possibility of entering into a reasonable deferred payment agreement. In the case of a residential customer receiving more than one different service from the same company, the statement shall state that deferred payment agreements are available separately for each Company service.

4.6.5 Notice to Company for Cancellation of Service

Customers desiring to terminate service shall provide Company proper notice of desire to terminate service. A customer wishing to discontinue service must give notice to that effect. Within 48 hours of said notice, the Company shall discontinue service or obtain a meter reading for the purpose of calculating a final bill. Where such notice is not received by the Company, the customer shall be liable for service until the final reading of the meter is taken. Notice to discontinue service will not relieve a customer from any minimum or guaranteed payment under any contract or rate.

4.6.6 Cancellation of Application for Service

- A) Applications for service may not be cancelled later than three (3) days after submission unless the Company otherwise agrees. Where the Company permits the Customer to cancel an application for service prior to the start of

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service or prior to any special construction, no charges will be imposed except for those specified below.

- A) Where, prior to cancellation by the Customer, the Company incurs any expenses in installing the service or preparing to install the service that it otherwise would not have incurred, a charge equal to the costs the Company incurred, less net salvage, shall apply, but in no case shall this charge exceed the sum of the charge for the minimum period of service ordered, including installation charges, and all charges others levy against the Company that would have been chargeable to the Customer had service begun (all discounted to present value at 6%).
- B) Where the Company incurs any expense in connection with special construction, or where special arrangements of facilities or equipment have begun, before the Company receives a cancellation notice, a charge equal to the costs incurred, less net salvage, applies. In such cases the charge will be based on such elements as the cost of the equipment, facilities, and material, the supervision, general and administrative expense, other provision for return on investment, and any other costs associated with the special construction or arrangements.

4.6.7 Changes in Service Requested

If the Customer makes or requests material changes in circuit engineering, equipment specifications, service parameters, premises locations, or otherwise materially modifies any provision of the application for service, the Customer's installation fee shall be adjusted accordingly.

4.7 Allowances for Interruptions in Service

4.7.1 General

- A) A credit allowance will be given when service is interrupted, except as specified in Section 4.7.2 following. A service is interrupted when it becomes inoperative to the Customer, e.g., the Customer is unable to transmit or receive, because of a failure of a component furnished by the Company under this draft tariff.
- B) An interruption period begins when the Customer reports a service, facility or circuit to be inoperative and, if necessary, releases it for testing and repair. An interruption period ends when the service, facility or circuit is operative.

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- C) If the Customer reports a service, facility or circuit to be interrupted but declines to release it for testing and repair, the service, facility or circuit is considered to be impaired but not interrupted. No credit allowances will be made for a service, facility or circuit considered by the Company to be impaired.

4.7.2 Limitations of Allowances

No credit allowance will be made for any interruption in service:

- A) Due to the negligence of or noncompliance with the provisions of this draft tariff by any person or entity other than the Company, including but not limited to the Customer or other common carriers connected to the service of the Company;
- B) Due to the failure of power, equipment, systems, connections or services not provided by the Company;
- C) Due to circumstances or causes beyond the control of the Company (including, but not limited to, civil disorder, fire, flood, storm or other natural or man-made disasters or elements, or labor problems);
- D) During any period in which the Company is not given full and free access to its facilities and equipment for the purposes of investigating and correcting interruptions;
- E) During any period in which the Customer continues to use the service on an impaired basis;
- F) During any period when the Customer has released service to the Company for maintenance purposes or for implementation of a Customer order for a change in service arrangements;
- G) That occurs or continues due to the Customer's failure to authorize replacement of any element of special construction;

4.7.3 Use of Another Means of Communications

If the Customer elects to use another means of communications during the period of interruption, the Customer must pay the charges for the alternative service used.

4.7.4 Application of Credits for Interruptions in Service

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- A) Credits for interruptions in service that is provided and billed on a flat rate basis for a minimum period of at least one month, beginning on the date that billing becomes effective, shall in no event exceed an amount equivalent to the proportionate charge to the Customer for the period of service during which the event that gave rise to the claim for a credit occurred. A credit allowance is applied on a pro rate basis against the rates specified hereunder and is dependent upon the length of the interruption. Only those facilities on the interrupted portion of the circuit will receive a credit.
- B) For calculating credit allowances, every month is considered to have thirty (30) days.
- C) A credit allowance will be given for interruptions in service of 15 minutes or more. Two or more interruptions of 15 minutes or more during any one 24-hour period shall be considered as one interruption.
- D) Interruptions of Twenty-Four (24) Hours or Less – Portion of Daily Per-Line Charge

Two or more service interruptions of the same type to the same line/equipment of two (2) hours or more during any one twenty-four (24) hour period shall be considered as one interruption. In no event shall such interruption credits for any one line/equipment exceed one (1) day's fixed recurring charges for such line/equipment in any twenty-four (24)-hour period.

<u>Length of Service Interruption</u>	<u>Credit</u>
Less than 4 hours	None
4 hours up to but not including 8 hours	1/3 of day
8 hours up to but not including 12 hours	1/2 of day
12 hours up to but not including 16 hours	2/3 of day
16 hours up to but not including 24 hours	One day

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E) Interruptions over Twenty-Four (24) Hours

Service interruptions over twenty-four (24) hours will be credited four (4) hours for each four (4)-hour period or fraction thereof. No more than one (1) full day's credit will be allowed for any period of twenty-four (24) hours.

4.7.5 Cancellation for Service Interruption

Cancellation or termination for service interruption is permitted only if any circuit experiences a single continuous outage of 8 hours or more or a cumulative service credits equaling 16 hours in a continuous 12-month period. The right to cancel service under this provision applies only to the single circuit which has been subject to the outage or cumulative service credits.

4.8 Cancellation of Service/Termination Liability

If a customer cancels a Service Order or terminates services before the completion of the term for any reason whatsoever other than a service interruption (as defined in Section 4.7.1), Customer agrees to pay Company termination liability charges, which are defined below. These charges shall become due and owing as of the effective date of the cancellation or termination and be payable within the period set forth in Section 4.6.2.

4.8.1 Termination Liability

Customer's termination liability for cancellation of service shall be equal to:

- A) all unpaid Non-recurring charges reasonably expended by Company to establish service to Customer; plus
- B) any disconnection, early cancellation or termination charges reasonably incurred and paid to third parties by Company on behalf of Customer; plus
- C) all Recurring Charges specified in the applicable Service Order for the balance of the then current term discounted at a rate determined by the Tennessee Regulatory Authority;
- D) minus a reasonable allowance for costs avoided by the Company as a direct result of Customer's cancellation.

4.9 Customer Liability for Unauthorized Use of Network

4.9.1 Unauthorized Use of the Network

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- A) Unauthorized use of the Network occurs when: (1) a person or entity that does not have actual, apparent, or implied authority to use the Network, obtains the Company's services provided under this draft tariff; or (2) a person or entity that otherwise has actual, apparent, or implied authority to use the Network, makes fraudulent use of the Network to obtain the Company's services provided under this draft tariff, or uses specific services that are not authorized.
- B) The following activities constitute fraudulent use:
- 1) Using the Network to transmit a message, locate a person, or otherwise give or obtain information, without payment for the service;
 - 2) Using or attempting to use the Network with the intent to avoid payment, either in whole or part, of any of the Company's tariffed charges by either rearranging, tampering with, or making connections not authorized by this draft tariff to any service components used to furnish the Company's services or using fraudulent means or devices, tricks, schemes, false or invalid numbers, false credit devices or electronic devices;
 - 3) Toll Free callers using the Network with the intent of gaining access to a Customer's outbound calling capabilities on an unauthorized basis; and
 - 4) Using fraudulent means or devices, tricks, schemes, false or invalid numbers, false credit devices or electronic devices to defraud or mislead callers.
- C) Customers are advised that use of telecommunications equipment and services, including that provided under this draft tariff, carries a risk of various forms of telecommunications fraud (including, but not limited to, toll and fraud perpetrated by Users who gain access to a Customer's facilities, account numbers, security or authorized codes, etc.). Customers should take all necessary steps to restrict access to their facilities, including the equipment and services provided hereunder, and to detect and prevent unauthorized use of the equipment and services provided by the Company under this draft tariff.

4.9.2 Liability for Unauthorized Use

- A) Except as provided for elsewhere in this draft tariff, the Customer is responsible for payment of all charges for services provided under this draft tariff furnished to the Customer or User. This responsibility is not changed due

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to any use, misuse, or abuse of the Customer's service or Customer-provided equipment by Users or other third parties, the Customer's employees, or the public.

- B) The Customer is responsible for payment of any charges related to the suspension and/or termination of service, and any charges for reconnection of service, incurred as a result of unauthorized use of the Network.

4.9.3 Liability for Credit Card Fraud

- A) The Customer is liable for the unauthorized use of the Network obtained through the fraudulent use of a Credit Card, provided: (1) the Credit Card is an accepted credit card, and (2) the unauthorized use occurs before the Company has been notified.

An accepted credit card is any credit card that a cardholder has requested or applied for and received, or has signed, used, or authorized another person to use to obtain credit. Any credit card issued as a renewal or substitute in accordance with this paragraph is an accepted credit card when received by the cardholder.

- B) The liability of the Customer for unauthorized use of the Network by Credit Card fraud will not exceed the lesser of \$50 or the amount of money, property, labor, or services obtained by the unauthorized user before notification to the Company.
- C) The Customer must give the Company notice that unauthorized use of a Credit card has occurred or may occur as a result of loss, theft or other reasons. For the purpose of this section, "notice" occurs when the Company receives a verbal or written confirmation that unauthorized use of a Credit card has occurred or may occur as a result of loss, theft or other reasons.

4.10 Use of Customer's Service by Others

4.10.1 Resale and Sharing

Any service provided under this draft tariff may be resold to or shared with other persons at the option of Customer, subject to compliance with any applicable laws or Tennessee Regulatory Authority regulations governing such resale or sharing. Customer remains solely responsible for all use of services ordered by it or billed to its

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telephone number(s) pursuant to this draft tariff, for determining who is authorized to use its services, and for notifying the Company of any unauthorized use.

4.10.2 Joint Use Arrangements

Joint use arrangements will be permitted for all services provided under this draft tariff. From each joint use arrangement, one member will be designated as the Customer responsible for the manner in which the joint use of the service will be allocated. The Company will accept orders to start, rearrange, relocate, or discontinue service only from the Customer. Without affecting the Customer's ultimate responsibility for payment of all charges for the service, each joint user shall be responsible for the payment of the charges billed to it.

4.11 Transfers and Assignments

Neither the Company nor the Customer may assign or transfer its rights or duties in connection with the services and facilities provided by the Company without the written consent of the other party, except that that Company may assign its rights and duties (a) to any subsidiary, parent company or affiliate of the Company; (b) pursuant to any sale or transfer of substantially all the assets of the Company; or (c) pursuant to any financing, merger or reorganization of the Company.

4.11 Notices and Communications

- A) The Customer shall designate on the Service Order an address to which the Company shall mail or deliver all notices and other communications, except that Customer may also designate a separate address to which the Company's bills for service shall be mailed.
- B) The Company shall designate on the Service Order an address to which the Customer shall mail or deliver all notices and other communications, except that Company may designate a separate address on each bill for service to which the Customer shall mail payment on that bill. The bill will contain both the mailing address for notices and communications as well as the address to which the payment is to be mailed.
- C) The bill will also contain for purposes of customer's questions regarding the customer's bill, a 24 hour customer service number which is 1-800-462-6823.
- D) The Company or the Customer shall advise the other party of any changes to the addresses designated for notices, other communications or billing, by following the procedures for giving notice set forth herein.

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5 SERVICE DESCRIPTIONS AND TECHNICAL STANDARDS

5.1 General

Local and HI-CAP, Private Line and Dedicated Services consist of any of the services offered pursuant to this draft tariff, either individually or in combination. Each service is offered independent of the others, unless otherwise noted.

Hi-Capacity (digital services affording bandwidth as specified), Private Line (including the full range of point to point transmissions), and Special Access (customer premise to carrier) services, (hereinafter, collectively, "Dedicated Services") are offered pursuant to the terms set forth herein. Each service is provided independently of the others. Services is offered by the company via its own facilities and/or the facilities of other carriers. Services are offered as one-way or two-way communications services, as specified. Special construction charges may apply in each case. Services may not be available to all customers. Such services may not be accompanied by 411, 911 or other voice services. In addition to the charges specified for each service, additional charges may apply for transfers of data per month or at certain times in excess of certain thresholds.

5.2 Service Descriptions and Technical Specifications

The following Dedicated Access Services are offered in this draft tariff:

DS3 Service	(44.736 Mbps)
DS2 Service	(6.312 Mbps)
DS1 Service	(1.5 Mbps)
Fractional Services	(Data rates may vary in either direction)
DS0 Service	(Up to 64 Kbps)

Other services, including fractional point-to-point high speed digital point to point services, may be provided by the Company on an Individual Case Basis (ICB), depending on such factors as length of loops involved, quality of loops and other factors. Fractional Services may be provided using a variety of digital transmission technologies, including as a part of technology and market trials. The availability of a service using a particular technology may be limited in accordance with the Company's policies and practices, which shall not be unreasonably discriminatory. During its trials, Company may provide such services to its employees or the general public or to limited categories of customers.

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6 RATES AND CHARGES

6.1 Rate Categories

Non-recurring and monthly recurring rates apply for each Dedicated Service furnished by the Company. Monthly recurring rates vary according to the time period for which the Customer commits to take the service. Unless otherwise noted, three standard rate elements are used in calculating the monthly recurring rate for each service:

- A) Local Distribution Channel (LDC): This rate element applies to each end-point of a digital channel provided to a Customer.
- B) Interoffice Channel Mileage-Fixed: This rate element applies per digital channel whenever there is mileage associated with the channel; a digital channel has mileage associated with it when the endpoints of the channel are located in geographic areas normally served out of separate local exchange carrier ("LEC") end offices. This rate element applies per circuit endpoint.
- C) Interoffice Channel Mileage-Per Mile: This rate element applies whenever there is mileage associated with the digital channel. The unit rate is multiplied by the number of miles (Interoffice Mileage) between the two LEC end offices serving the geographic areas in which the end points of the channel are located. Interoffice Mileage is determined according to the V&H coordinates method set forth in the NATIONAL EXCHANGE CARRIER ASSOCIATION, INC. TARIFF F.C.C. No. 4. Fractions of a mile are rounded up to the next whole mile before rates are applied.

6.2 Basic and Mixed Vendor Services

DS3, DS2, DS1 and DS0 Service may be provided as either Basic or Mixed Vendor Services, depending upon the availability of facilities. Basic Service rates apply when both endpoints of the channel are served by the Company's network. Mixed Vendor Service rates when one endpoint of the transmission channel is served by a local exchange carrier's network (Mixed vendor Services are provided via a combination of the Company's facilities and local exchange carrier facilities).

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DS3, DS2, DS1 and DS0 channels where both endpoints are served by a local exchange carrier's network will be provided at the sole discretion of the Company, on an Individual Case Basis (ICB).

Optional features and functions are also available on an Individual Case Basis, these are:

Cross-Connection Charge: This rate element applies for cross-connections within Company locations between one or more Customer services, or between the services of different Customers.

Multiplexing Charge: This rate element applies where the Customer requests that its services be multiplexed onto higher bandwidth facilities for delivery to the Customer.

DEXCS Port Charge: This rate element applies where the Customer requests that its services be connected to a DEXCS port.

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6.2.1 DS3 SERVICE (44.736 Mbps)

This service consists of a DS3 (44.736 Mbps) capacity digital channel available on a 24 hour per day, 7 day per week basis between two points.

TYPE I DS3 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)				
Zone 1	\$2,250	\$2,250	\$1,620	\$1,440
Zone 2	\$2,250	\$2,250	\$1,710	\$1,530
Zone 3	\$2,250	\$2,250	\$1,800	\$1,620
Interoffice Channel Mileage (Fixed)				
Zone 1,2,3	\$750	\$750	\$675	\$600
Interoffice Channel Mileage (Per Mile)				
Zone 1,2,3	\$39	\$39	\$35	\$31
Installation Rate				
Zone 1	\$2,700 Per Local Distribution Channel			
Zone 2	\$2,900 Per Local Distribution Channel			
Zone 3	\$3,100 Per Local Distribution Channel			

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DS3 SERVICE (Continued)

TYPE I DS3 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)	\$1,080	\$1,080	\$665	\$585
Interoffice Channel Mileage (Fixed)	\$540	\$540	\$486	\$432
Interoffice Channel Mileage (Per Mile)	\$54	\$54	\$50	\$43
Installation Rate	\$800 Per Local Distribution Channel			

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- 2) VOLUME DISCOUNTS WILL APPLY WHEN A CUSTOMER ORDERS TWO OR MORE DS3 CIRCUITS BETWEEN THE SAME LOCATIONS AT THE SAME TIME.

6.2.2 DS2 SERVICE (6.312 Mbps)

This service consists of a DS2 (6.312 Mbps) capacity digital channel available on a 24 hour per day, 7 day per week basis between two points. No mixed vendor service is available for DS2 service.

STANDARD DS2 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)	\$1,150	\$1,150	\$1,035	\$920
Interoffice Channel Mileage (Fixed)	\$570	\$570	\$513	\$456
Interoffice Channel Mileage (Per Mile)	\$29	\$29	\$26	\$23
Installation Rate	\$2,700 Per Local Distribution Channel			

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RATES FOR DEDICATED ACCESS SERVICES
DS3 SERVICETYPE II DS3 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)	\$1,140	\$1,140	\$702	\$618
Interoffice Channel Mileage (Fixed)	\$570	\$570	\$513	\$456
Interoffice Channel Mileage (Per Mile)	\$57	\$57	\$53	\$45
Installation Rate	\$800 Per Local Distribution Channel			

VOLUME DISCOUNTS
LOCAL DISTRIBUTION CHANNEL

	MONTH TO MONTH	RATE PER DS3 CHANNEL		
# OF DS3'S		1 YR.	3 YR.	5 YR.
3 DS3s				
Zone 1	\$2,097	\$2,097	\$1,140	\$900
Zone 2	\$2,097	\$2,097	\$1,170	\$975
Zone 3	\$2,097	\$2,097	\$1,200	\$1,050
12 DS3s				
Zone 1	N/A	N/A	\$825	\$630
Zone 2	N/A	N/A	\$844	\$653
Zone 3	N/A	N/A	\$863	\$675

NOTES:

- 1) IN ADDITION TO THE ABOVE LOCAL DISTRIBUTION CHANNEL CHARGES, ADD THE STANDARD FIXED AND PER MILE RATES.

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6.2.3 DS1 SERVICE (1.544 Mbps)

This service consists of a DS1 (1.544 Mbps) capacity digital channel available on a 24 hour per day, 7 day per week basis between two points.

RATES FOR DEDICATED ACCESS SERVICES
DS1 SERVICE

TYPE I DS1 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)	\$234	\$234	\$211	\$187
Interoffice Channel Mileage (Fixed)	\$54	\$54	\$49	\$43
Interoffice Channel Mileage (Per Mile)	\$14	\$14	\$13	\$11
Installation Rate	\$450 Per Local Distribution Channel			

When more than one circuit is purchased at the same time and between the same locations, each additional circuit receives 50% off the above LDC, and the installation rate is \$65 per additional LDC

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DS1 SERVICE (1.544 Mbps)TYPE II DS1 RATES

RATES	MONTH TO MONTH	1 YR.	3 YR.	5 YR.
Local Distribution Channel (Per Channel)	\$247	\$247	\$223	\$197
Interoffice Channel Mileage (Fixed)	\$57	\$57	\$52	\$45
Interoffice Channel Mileage (Per Mile)	\$14	\$14	\$13	\$12
Installation Rate	\$450 Per Local Distribution Channel			

6.2.4 Fanout DS1 Service

This service consists of up to 28 DS1 (1.544 Mbps) digital channels, which are aggregated at a Company Node onto a standard DS3 circuit with Interoffice Mileage and a Local Distribution Channel at the terminating end.

Fanout DS1's consist of 3 rate elements:

- 1) **DS1 Local Distribution Channels** - Rated as a standard DS1 Local Distribution Channel.
- 2) **Central Office Multiplexing** - Aggregates the 28 DS1's onto DS3 interoffice facilities.
- 3) **DS3 Interoffice Mileage/Local Distribution Channel** - rated as a standard DS3 Circuit.

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FANOUT DS1 SERVICE RATES

SERVICE CONFIGURATIONS	NON-RECURRING		MONTH TO MONTH		MONTHLY RECURRING					
					1 YR.		3 YR.		5 YR.	
DS3/1 Mux @ CC Node		\$400		\$440		\$440		\$395		\$350
DS3 Channel Between a Client Premises and a CC Node	Standard DS3 Rate Schedule (One Local Distribution Channel Charge applies)									
DS1 Fanout Channel	Standard DS1 Rate Schedule (One Local Distribution Channel Charge applies to each individual DS1 Fanned out from Node))									

6.2.5 DSO Service

DS0 Service is a Digital Transmission Service furnished by the Company at transmission speeds of 2.4 kbps, 4.8 kbps, 9.6 kbps, 19.2 kbps, 56 kbps, 64 kbps, or in multiples of 56 kbps or 64 kbps up to 1.544 Mbps. Such channels will be configured by the Company to transmit digital data at specified data rates or analog signals converted to digital signals.

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STANDARD DS0 RATES

DSO SERVICE	NON-RECURRING*	MONTHLY RECURRING	
		DSO LOCAL DISTRIBUTION CHANNEL (EACH)	DSO MILEAGE
2 wire voice grade	\$475	\$27.00	\$22.00 plus \$0.50 per mile
4 wire voice grade	\$475	\$42.00	\$22.00 plus \$0.50 per mile
2.4 to < 56 kbs	\$350	\$45.00	\$4.50 plus \$5.00 per mile
56 or 64 kbs	\$350	\$45.00	\$4.50 plus \$5.00 per mile
	\$250 x N with \$3,000 MAX	\$36.00 x N	\$4.50 plus \$5.00 per mile X N

6.2.6 Fanout DS0 Service

This service consists of up to 24 DS0 digital channels, which are aggregated at a Company Node onto a standard DS1 circuit with Interoffice Mileage and a Local Distribution Channel at the terminating end. There is a minimum 90 day service period for each Hubbed DS0 Service.

Hubbed DS0's consist of 3 rate elements:

- 1) **DS0 Local Distribution Channels** - Rated as a standard DS0 Local Distribution Channel.
- 2) **Central Office Multiplexing** - Aggregates the 24 DS0's onto DS1 interoffice facilities.
- 3) **DS1 Interoffice Mileage/Local Distribution Channel** - Rated as a standard DS1 Circuit.

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DS0 FANOUT SERVICE

STANDARD RATE ELEMENTS	NON- RECURRING	MONTHLY RECURRING			
		MONTH TO MONTH	1 YR.	3 YR.	5 YR.
DS1 Service	Apply Standard DS1 Non- Recurring Charge	Standard DS1 Rate Schedule			
DS1/0 MUX @ TC Node	\$0	\$248	\$248	\$223	\$198
DS0 Service	Apply Appropriate DS0 Non-Recurring Charge	Standard DS0 Rate Schedule			

6.2.7 Individual Case Basis (ICB) Arrangements

For special situations, rates for Dedicated Access Services and other specialized services will be determined on an Individual Case Basis (ICB) and specified by contract between the Company and the Customer.

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6.4 Taxes and Surcharges

6.4.1 Customer Responsibility

The Customer is responsible for the payment of any sales, use, excise, access or other local, state and federal taxes, charges or surcharges (excluding taxes on the Company's net income) imposed on or based upon the provision, sale, or use of Company's services.

All such taxes and surcharges shall be itemized on the Company's bills to the Customer.

6.4.2 Excise Taxes and Funds

Company agrees to collect and remit social program excise taxes levied upon all end users of regulated telecommunications services pursuant to TRA rules. Company also agrees to collect and remit relevant federal taxes.

6.4.3 Sales, Use, and Excise Taxes

In addition to all recurring, non-recurring, usage or special charges, Customer shall also be responsible for and shall pay all applicable federal, state, and local sales, use, and excise taxes.

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